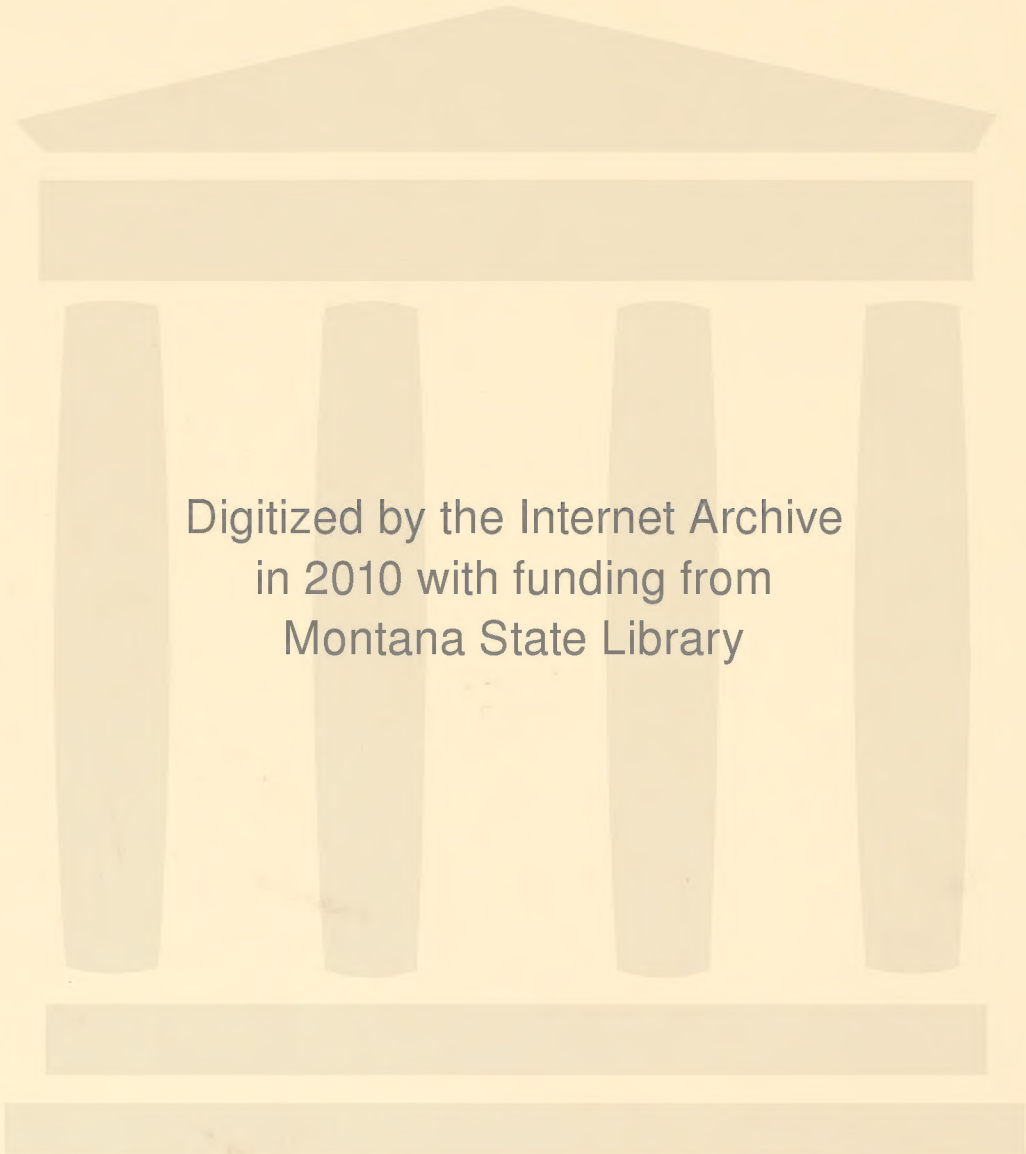
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STATE OF MONTANA

EVALUATION OF DEFERRED COMPENSATION PLAN

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February 1996

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DRAFT
SUBJECT TO
PEER REVIEW
AND REVISIONS

INTRODUCTION

The State of Montana retained William M. Mercer, Inc. ("Mercer"), to assist it in a review of the Montana State Deferred Compensation Plan (the "Plan"). Specifically Mercer was to address the following tasks:

- Provide a comprehensive review of current providers and plan design. Our review will compare current fees and charges against average fees and charges within relative industry categories and marketing and administrative services.

- Review the funds offered by Nationwide and comment on the appropriateness compared to industry norms.

- Analyze the performance of each investment option provided by the Plan.

- Analyze the feasibility of the State providing a fixed fund in-house and comment on the advisability of managing the fund in-house versus hiring an independent manger.

Mercer is to present its report to the State Employee Group Benefits Advisory Council (the "Council"), which provides guidance to the State Department of Administration.

To gather information for the review, Mercer sent questionnaires and conducted telephone interviews with representatives of D.A. Davidson & Co. (DADCO) and Nationwide Life Insurance Company (Nationwide). Staff at both DADCO and Nationwide were open and responsive in answering our questions.

The intent of this report is to provide the Council with a discussion piece that addresses the issues listed above. We believe this approach will allow the Council more flexibility in dealing with issues and will allow it to prioritize areas for future review.

Note: Participant information provided by DADCO was for 1994. Updated 1995 information was not expected to be available until March 1.

GLOSSARY OF TERMS

To assist in the Council's understanding of this report and our discussions, we have prepared an explanation of the following terms:

- Marketing and enrollment:
  - Communicating plan to prospective participants,
  - Enrolling participants.
- Recordkeeping and administration:
  - Maintaining individual plan account balances,
  - Processing deposits, transfers, charges, withdrawals,
  - Preparing and distributing participant statements of account,
  - Maintaining plan financial records.
- Allocated investment product - an investment product in which the investment provider maintains individual participant account records. Under the State Plan Nationwide maintains participant records.
- Unallocated investment product - an investment product in which the investment provider does not maintain individual participant account records and instead maintains only one account in the name of the plan sponsor.
- Fixed investment product - provides stated rate of return. The Montana Plan's fixed investment option is a general account fixed annuity contract with Nationwide Life Insurance Company.
- Variable investment product - all investments other than fixed including:
  - Common stock funds,
  - Bond funds,

- ❖ Balanced funds,
- ❖ Money market funds,
- ❖ Variable annuities.

The Montana Plan's variable investment is a variable annuity with Nationwide Life.

- ➢ Third Party Administrator (TPA) - Entity other than plan sponsor that provides marketing, enrollment, recordkeeping and/or administrative services.

- ➢ Service provider - generic reference to a TPA or investment company that provides 457 plan related services such as marketing, enrollment, recordkeeping and/or administrative services.

- ➢ Plan or program - arrangements made by a governmental entity to allow employees to defer salary on a pre-tax basis.

- ➢ Investment provider - insurance company, bank, savings and loan, mutual fund or other organization that provides fixed or variable investment products.

- ➢ Guaranteed Investment Contract (GIC) - an insurance contract offered by insurance companies which offers a fixed interest rate on a certain sum of monies for a fixed period of time. At the end of the contract, the funds are available in a lump sum of principal plus interest with no penalties or restrictions.

- ➢ General Account - main investment account of the carrier. This contains all assets that back general contracts of the carrier. Ultimate solvency and payment of liabilities are backed by the full faith and credit of the carrier. General Account assets are accessible by the general creditors of the carrier.

- ➢ Separate Account - these are accounts which are established for individual policyholders or groups of policyholders. Investment returns are experience rated based on performance of the account. It is intended that these accounts can not be attached by creditors and would not be liable for claims made against the General Account. Policyholders may only look to the assets in the account to satisfy claims.

FINDINGS:

Marketing and Enrollment

The State's Plan participation percentage is good compared to other large rural states.

The number of hardship withdrawals which almost tripled in 1995 over 1994 requests is high when compared to other plans that we are familiar with, however, requests for withdrawals has. We suggest the State and DADCO investigate the reason for the increase.

The 1995 average annualized deferral for Plan participants is approximately $2,400. This is a typical annual deferral as compared to the average deferrals in other plans. We understand that contributions are fixed dollar amounts. We suggest the State consider changing to percentage of payroll.

DADCO has two enrollers. This equals one enroller for every 2,000 participants.

Participant Recordkeeping and Servicing

Nationwide maintains the records as part of its role of providing investments.

We would suggest that the State consider providing more in-house monitoring of the Plan. As plan sponsors recognize the responsibilities associated with sponsoring plans with many millions of dollars of assets, sponsors are increasingly assessing disclosed fees to participant accounts to pay for this oversight.

Investment Options

There are too many investment options in the Plan. In fact, there are many funds with small amounts of assets and to which only a small portion of total deferrals is directed. The large number of variable funds is particularly inappropriate

since participants defer almost 78% of total contributions to the fixed investment options. As of December 31, 1995, almost 84% of Plan assets were in the fixed option.

We suggest that the Council restructure the Plan with fewer options but with better investment performance potential and clear diversification of risk. We suggest funds be grouped by asset category and selection be based on performance.

Fixed Investment Performance

The primary consideration when evaluating fixed products is the credit worthiness of the underlying insurance company. In this regard, Nationwide Life Insurance Company is a very high quality carrier.

We have tried to compare the fixed option performance by hypothetical account balance accumulations. Nationwide's rate has been competitive. We suggest that the Council adopt an investment policy and credit policy and guidelines.

Variable Investment Performance

Of the thirty seven (37) variable options, performance has varied significantly. We suggest that the Council adopt investment policies and guidelines for each investment category.

Investment Transfer Restrictions

Because there are no competing investment options, participants can freely transfer between investments except for the fixed, which has a transfer limit of 10% of total fixed assets. This limit could be eliminated with other fixed investment vehicles. If retained, participants should be apprised that the limitation is based on aggregate Plan funds.

Plan level transfers will be limited to 1) payment over sixty (60) months, or 2) lump sum subject to a market value adjustment.

Participant Communications

The participant statement should be in a more attractive format and the enrollment forms and other communications materials should be more tailored to the Plan

Payouts

The State should develop a communications program that would formalize the payout process.

Over 80% of annuities selected were designated period annuitites. The internal rate of return on these is 5.5% whereas the current return on the fixed option is 7.15%. At this rate, it would have been better for the person to remain in the fixed option. The State may want to explore the reason for participant selection of this option.

Fees and Charges

The undisclosed margin in most fixed annuity products is between .50% and 1.0%. The disclosed mortality, risk and expense charge in most variable annuities is between .90% and 1.3%. The margin for Nationwide fixed annuity is undisclosed. The charge for the variable annuity is 0.95%.

Nationwide has eliminated the participant level deferred sales charges and will eliminate the Plan level charges at the end of the present contract. This represents the fact that the amounts paid to DADCO are paid by the Plan rather than the insurance company as is normally the case when commissions are involved.

DADCO is paid for its services through commissions deducted as an asset charge on the Plan assets. Revenue collected by DADCO in 1995 was $245,000.

RECOMMENDATIONS:

- In our report we listed numerous recommendations with regard to the existing programs. This section of the report will:
  - Outline Plan design alternatives and the pros and cons of each of those alternatives
  - Give our recommendations for the future design of the program
  - Discuss the implications of design changes or investment product offerings on current products and methods to reduce the impact on participants

Investments--Fixed

- The Plan is really at the turning point. It now has sufficient assets to operate on an unbundled basis if it chose to do so since it already pays for its marketing costs directly. In light of the above, our recommendation is that the State modify its plan so that it is truly an unbundled arrangement. The State would select its own investment options then hire an administrator to provide the services required to administer the Plan.

- In modifying the Plan, there are a variety of practical steps that must be taken and issues and complications that must be addressed. The first step is to determine the design of the investment options that are to be offered under the Plan. As outlined in our report, we suggest that the State limit the number of investment options under the Plan. For example, the Plan should have one fixed option. Some of the choices available and the characteristics of each are:

- General Account Fixed Annuity

  - Participants are already familiar with this option.

  - Product may be able to be structured so that there are no deferred sales charges assessed at participant and plan level termination or that plan level termination charges are of a limited duration.

  - There are restrictions (usually a percentage of total assets or participant account values) on the amount of assets that can be transferred to other investment options.

  - There is credit risk which can be reduced by:

    - Selecting high quality companies and monitoring their financial situation.

    - Diversifying assets between two or more insurance companies. The size of the Plan might make this alternative difficult to achieve on a practical basis. Diversification should be plan, not participant directed. For example, an insurance company annuity pool (may not fit with certain insurance companies marketing preferences) with a blended interest rate. Another less attractive method is to split participant deferrals between two or more companies. This split would be determined by the Plan not by the participant.

- GIC Fund
  - Diversification is excellent.
  - Management of the fund can be retained by the State (SBI - with outside assistance as needed) or delegated to a GIC fund manager.
  - This option is common in private sector defined contribution plans and may be familiar to many participants.
  - Returns are likely to be slightly (.5% to 1%) lower than for a fixed annuity. GICs tend to have a shorter duration than fixed annuities.
- Separate Annuity (see Glossary for definition)
  - Arrangement would be a separate account of bonds or other fixed income securities.
  - The State would hold claim to the underlying assets in the separate account (as is true in current variable annuity arrangements). Investments in the separate account would not be subject to the claims of general creditors as they would be if invested in the annuity carrier's general account.
  - The State could set investment guidelines such as bond duration, credit quality, etc. The annuity carrier invest in accordance with these guidelines.
  - Rates of return would be fixed on a periodic basis and the overall account would be experience rated. All of the returns and costs would be fully disclosed to the State.
  - Although participant benefit payments are guaranteed to be at book value, payment at termination of the contract would be at true market value.

Implementation Issues

- One of the primary considerations that arises when a plan sponsor considers making significant changes to its investment offerings is what to do with existing investment options. Choices are:

  - Add new funds as an addition to existing options,

  - Freeze existing funds and use the new investment options for current and future salary deferrals,

  - Eliminate existing funds and transfer money to the new investment options.

- As mentioned in our report we do not recommend that new funds be added to the existing plan options. We feel that investment selection should be limited to a reasonable number of funds. If the existing funds were not selected because they did not best satisfy the criteria that is set, we do not recommend that participants be able to continue to defer.

- Freezing existing funds should be done only if transferring existing options is not a practical alternative. For example, the amount of penalties assessed on termination is too great to allow amortization under the plan and still pay participants a competitive interest rate. Continuing to have a large number of investment options means that the State must continue to monitor the stability of each investment company and the performance of each fund. If a frozen fund turns out to have better investment performance in a given period participants may be angry that they cannot take advantage of it.

- We recommend that the State consider the third option if at all possible. Currently, many investment providers are anxious to take over substantial amounts of assets and may be willing to make up losses that will occur on transfer. The State's first step would be to quantify the market value adjustment to the fixed option that would be assessed if its investment contract were terminated. There is no penalty on the variable annuity after the end of 1996 and assets could be transferred at market. In fact, the individual mutual funds could be retained. Then as part of the investment selection process companies are asked to describe their willingness to take transfer of the existing assets at book value. Of course, there is no free lunch and the investment companies must be able to recoup the cost of the book value transfer (called a "gross up") from its expected profit. The method for doing this varies by carrier and also by

type of investment option. Customarily, the cost of the gross up is borne by the fixed investment option since the cost of amortizing the gross up can be deducted from the investment return or margin.

Recommendations--Fixed Investment

- We recommend that the State consider restructuring its fixed interest guarantee product. This restructuring would start with termination of the existing fixed annuity contract with Nationwide. The funds invested in these products would be transferred to either:

  - a diversified group of insurance company general account fixed annuity contracts, or
  - a diversified group of insurance company separate account fixed annuity contract, or
  - a diversified portfolio of GICs or SGICs.

Financing Transfer of Existing Assets

- If the State terminates its existing fixed investment contract and transfers assets to the new investment, participants will have their account balances reduced by the amount of the market value adjustment. In order for any transfer to be acceptable to participants, this loss must be recompensed or "grossed up". When bundled packages change hands the cost of the transfer is absorbed by the acquiring company. The company prices the cost of this indirect loan (the grossed up amount) to the plan in its cost of acquiring the business. It is our understanding that the lion's share of the cost is paid by the profit generated from the fixed investment option.

  It would be difficult if not impossible to recoup the costs of the gross up from participants who elect variable fund investments. Based on the fact that most assets in the State's Plan are in fixed investments, it would be most expeditious for the fixed option to bear the cost of the gross up. The method used to handle the gross up depends on the fixed investment option selected as outlined below:

- General Account Fixed Annuity. The insurance companies would price the cost of the gross up in their quote. It would be expected that such a gross up will require the imposition of a rear end load that at least some carriers will eliminate at a fixed point in the future. The insurance company will also factor in the cost of providing and/or paying for any administrative services or payment to the State from its investment margin a fee (presumably, but not necessarily, an asset based fee). This fee would be invisible to participants. If the State deducts a visible fee from each participant's account to pay for the administrative costs of the plan this pricing factor will not be necessary unless upfront plan transition costs incurred by the State are to be reimbursed.

  It should be noted that most insurance company group annuity products for the deferred compensation plan market are bundled arrangements so that the full universe of deferred compensation providers would not be expected to respond to an RFP for this type of arrangement. However, it is our expectation that several high quality insurance companies could be expected to respond.

- GIC Fund. We have assumed for purposes of this discussion that the GIC fund would be an individually managed fund (managed either by the State with outside assistance or by an outside GIC manager). The cost of the gross up will probably be difficult to amortize directly through the GIC contracts and it is likely that the cost would have to be directly amortized by the Plan. It is likely that this would involve having the recordkeeper account for each participant's account balance at the pre-transfer value. The actual value of the GIC contracts within the GIC fund would be less than this pre-transfer value. The difference between these values would be gradually made up from recoupment from paying a lower interest rate to participants.

- Separate Account Fixed Annuity. When a separate account is used as the funding vehicle in a transfer situation in which a gross up must be made, the plan obtains a loan from the insurance company for the grossed up amount. This loan is then repaid by reducing the earnings of the fund. This is essentially the same process that is done under the group fixed annuity, the difference being that the components are much more disclosed and the State can be involved in setting rates and determining the amortization period.

- Whether to use a general account or a separate account annuity will depend on the amount of any potential loss incurred upon termination of the contract and current interest rates. Credit standards and investment guidelines appropriate for the option selected should be established for the fixed option.

- Well in advance of termination, the State should request from Nationwide a quote on the estimated amount of market value adjustment.

Recommendations--Variable Investments

- The next step is to design the variable investment options. We recommend that the State consider independent stand-alone mutual funds, rather than insurance company variable annuities. If the State is going to use an independent TPA there is no reason to pay the additional 0.95% for mortality, risk and expense charges associated with the variable annuity products. It should be noted that the State will pay a charge for administrative services, but we would expect the charge to be lower than the risk, mortality and expense charges currently assessed. These mutual funds would replace the existing variable annuity. We understand that the State law may not currently allow for investments in stand alone mutual funds. We suggest that the substantial benefits of such investments justify a change in the law. Pending any change, we suggest that the State consider either a private label variable annuity under which the State can select funds or a reduction in the wrapper charges and the ability to select funds within the annuity.

  One of the first considerations in this area is whether or not to use families of funds. While a family of funds permits immediate transfer between funds, it is our experience that arrangements can be made with the administrator and the mutual fund companies so that transfer can be accomplished on a same day or next day basis. We recommend that the State not limit itself to a family of mutual funds and instead select the best performing mutual funds in each of the investment categories that are determined to be in the plan. The flexibility of not being tied to a family of funds means that the State can select the best performing fund that meets the investment objectives and criteria that have been determined.

  We suggest that the State continue to structure its variable investment options by investment risk category. Categories would include:

  - Aggressive Growth
  - Growth
  - Growth and Income
  - Income

- ❖ Socially Responsible
- ❖ International

We also suggest that the State offer at least two or three different mutual funds in the first four categories. The funds should be selected based on factors such as performance, name recognition and investment style. We recommend that, if possible, restraints on transfers between fixed and variable options as well as between variable options be kept to a minimum.

We also suggest that the Plan set criteria for the variable investments that will be monitored at least annually on an on-going basis. The State should also determine how a non-performing fund will be handled. We suggest that participants be told that the State has established performance standards and that if a fund fails to satisfy those standards that it will be replaced by a comparable fund and all assets moved.

Recommendations--Administration

- ➢ Once the investment design has been finalized, the specifications that an administrator must satisfy must be set out, a request for proposal prepared and a company selected. We suggest that a competitive bid process be undertaken.

- ➢ We suggest the administrator be compensated on a fee for service basis. This would mean that the administrator's compensation would be based solely on the services performed for the State. Based on the size of the Plan assets it would probably make the most sense to collect the money necessary to pay the administrator as an asset based fee.

- ➢ It is also not required, although it may be preferred, that all services are provided by one company. For example, recordkeeping may be conducted by one company, marketing and enrollment, fund split and participant servicing by another. The advantage of doing this is that:

  - ❖ Companies that are good at marketing and enrollment may not be as good at recordkeeping and vice versa.
  - ❖ It limits the upheaval that is involved if a company does not perform up to expectations and must be replaced. For example, if the marketing and enrollment force is replaced, recordkeeping will be unaffected.
  - ❖ It preserves flexibility so that if, in the future, the State should decide to take some activities, such as marketing or participant servicing, in-house, as many deferred compensation plan sponsors are doing, it can be accomplished without affecting the recordkeeping services.

Recommendations--Communications

- We recommend that the State implement a program to communicate the changes and stress the advantages of the redesigned plan:

Recommendations--Payouts

- We recommend the State as part of its restructuring add at least one additional annuity provider to allow for competition and choice at payout. Since no deferred sales charge will be assessed on termination, a participant will be free to select his or her payout provider based on the competitiveness of the purchase rate for the type of annuity that he or she has selected.

METHODS OF PROVIDING DEFERRED COMPENSATION PLAN SERVICES

- Bundled approach:
  - Description
    - Usually uses commission based investment products.
    - Investment products used in deferred compensation plans have generally been allocated.
    - Investment provider generally uses commissions to pay TPA to provide marketing and enrollment services.
    - Investment provider performs recordkeeping and administration.
    - Investment margin is used to pay commissions, however, because commissions are advanced, product has to retain assets to break even.
    - Need to break even results in deferred sales charges to assure investment provider retains assets or is recompensed for loss due to termination, withdrawal or transfer.
  - Advantages
    - Plan sponsor can maintain plan at no direct cost to itself.
    - Investment provider takes risk of whether plan will be successful.
    - Employees often see less in disclosed fees, although fees are probably not less than on a fee for service arrangement.

- Plan sponsor has less responsibility for coordination between investment providers and reconciliation of assets.
- Plan sponsor has to deal with one organization only.

❖ Disadvantages

- Plan sponsor has to make long term commitment.
- Plan sponsor loses some flexibility and control.
- Terminating relationship is difficult and often costly.
- Selection of investment products is limited to those of parent investment company.
- Potential credit risk exposure due to limitation of funds to one provider.
- Cost of services is difficult to determine because pricing is interrelated and generally dependent on purchase of entire package.

➢ Unbundled approach:

❖ Description

- Investment provider and TPA are separate.

- TPA is paid one or more of the following:
  - commissions
  - asset based fee
  - percentage of deferrals
  - administrative (flat dollar) fee
  - miscellaneous (i.e., transfer or enrollment) fees
  - deferred sales charges
- Enrollers are often still paid by TPA on commission basis.

❖ Advantages

- For large, mature plan, asset based fee can cover most expenses including start up costs over a short-term contract period.
- Investment selection is independent of TPA arrangement.
- Investment selection may include non-related products in terms of type and product.
- Plan sponsor has more flexibility of fee selection.
- Plan sponsor can diversify investments and reduce credit risk.
- Plan sponsor has more flexibility in design and structure of investments.

- ❖ Disadvantages
  - Plan may not be in a situation that allows full unbundled approach:
    - existing contracts
    - small asset base
  - Participants will see more disclosed fees although overall fees are usually not higher.
  - Generally requires more involvement by plan sponsor.
  - Plan sponsor will have to deal with multiple providers.

➢ Hybrid Approach:

- ❖ Many plans combine features of both bundled and unbundled plans.
- ❖ Usually a bundled package provider provides marketing, enrollment and /or recordkeeping services for other non-related investment providers in addition to its own.

➢ The State of Montana Plan uses a hybrid approach. Investment and administrative services are provided by Nationwide. Marketing and customer support services are provided by DADCO.

➢ History and trends:

- ❖ Most plans started out in 1970's using bundled approach.
- ❖ Large insurance companies were primary players.
- ❖ As assets in deferred compensation plans grew:

- More companies were interested and competition increased.
- Competition included other financial institutions and stand-alone service providers.

❖ Plan sponsors are trying to take advantage of the flexibility that large amounts of assets allow and are tending toward more unbundled approach.

DEFERRED COMPENSATION PLAN SERVICES

The following chart provides a comparison of the Plan services with selected deferred compensation plans.

Plan	Marketing Performed by	Enrollment Services Performed by	Recordkeeping Performed By	Method of Compensation
Ohio	TPA	TPA	State provides consolidated recordkeeping and individual account recordkeeping for variable options is provided by the providers.	Percentage of assets.
Nevada	Insurance Company	Insurance Company	Insurance Company maintains participant records for all investments. Produces consolidated statements for other investment options.	Per participant asset based charge, percentage of assets, surrender charge.
Los Angeles County	TPA	TPA	TPA Maintains participant records for all investment products. Produces consolidated statement.	Per participant charge based on services used and size of account.
Maryland	TPA	TPA	TPA Maintains participant records for all investment products. Produces consolidated statement.	Per participant charge, percentage of assets, surrender charge.
Massachusetts	TPA	TPA	TPA Maintains participant records for all investment products. Produces consolidated statement.	Percentage of assets.

Plan	Marketing Performed by	Enrollment Services Performed by	Recordkeeping Performed By	Method of Compensation
Montana	DADCO	DADCO	Investment provider maintains participant records.	Percentage of assets as determined by commission based fee schedule.
Michigan	State	State	State provides consolidated recordkeeping and individual account recordkeeping for variable options is provided by the investment providers.	Percentage of assets.
Wisconsin	TPA	TPA	TPA Maintains participant records for all investment products. Produces consolidated statement.	Per participant charge plus percentage of assets.
California	State	State	TPA Maintains records for all investment products. Produces consolidated statement.	Per participant charge, transaction charges, float on deposits.
Hawaii	TPA	TPA	Investment providers maintain participant records. Separate statements.	Commissions paid by investment companies.
South Dakota	TPA	TPA	TPA Maintains participant records for all investment products. Produces consolidated statement.	Per participant charge, service charges (transfer, processing, mailing) and percentage of assets.
Washington	State	State	State	Percentage of assets.

Participation

- The percentage of eligible State (non-University) employees participating in the Plan in 1994 was 30% up from 28% in 1993. It is our understanding the participation level in 1989 was only about 20%. DADCO continues to make strides in improving the participation of State employees in the Plan.

- Participation for University employees in 1994 was 10%. This is a high participation rate for a 457 plan for educational employees. DADCO attributes this to the consistency of their marketing effort, which includes regular visits and attendance at University benefits fairs.

- Usually the features available in 403(b) programs:

  - loans
  - funded status
  - ability to rollover distributions to an IRA

  make participation in a 403(b) more attractive for educational employees than participation in a 457 plan. For that reason most deferred compensation marketing organizations do not dedicate a great deal of their resources to marketing to the educational market. Since DADCO is compensated on a commission basis and are only paid on actual enrollments, there is no negative cost associated with expending enrollment resources in this area as long as it does not detract from adequate enrollment services to non-University State employees.

- Participation levels of deferred compensation plans vary greatly.

Plan	Approximate Percentage of Participants 1993	Marketing By
Alaska	33	TPA
Arizona	43*	TPA
Arkansas	27	IP**
California	51	State
Colorado	19*	TPA
Connecticut	29*	IP
Delaware	8*	IP
Hawaii	43*	TPA
Illinois	21*	TPA
Indiana	28	TPA
Iowa	29	IP
Kansas	37	IP
Kentucky	7*	TPA
Louisiana	12*	TPA
Maine	30	IP
Maryland	34	TPA

Plan	Approximate Percentage of Participants 1993	Marketing By
Michigan	69	State
Minnesota	26*	TPA
Mississippi	10*	TPA
Missouri	36	TPA
Montana***	28	TPA
Nebraska	18	IP
Nevada	35	IP
New Hampshire	43	TPA
New Jersey	13*	State
New Mexico	37*	TPA
New York	27*	TPA
North Carolina	8*	TPA
Ohio	27*	TPA
Oklahoma	14	State
Oregon	26	IP
Pennsylvania	17	TPA
South Dakota	14	TPA

Plan	Approximate Percentage of Participants 1993	Marketing By
Rhode Island	11	IP
Tennessee	20*	TPA
Texas	4*	IP
Utah	10*	State
Virginia	5*	IP
Washington	28*	State
Wisconsin	28*	TPA
Wyoming	24*	TPA
AVERAGE	**25.09**	

* Includes educational employees eligible to participate
** IP = Investment Provider
*** Does not include eligible educational employees

Source: National Association of Deferred Compensation Administrators

- The Plan's current penetration for State employees (30%) is especially good after taking into consideration the State's rural makeup.

- The State currently has chosen not to make the Plan available to local government entities although authorized under its charter. Our experience indicates that many State deferred compensation plans, make their offerings available to local entities; however, this is an issue that should be decided based on the unique situation of each state. The factors to be considered in making this decision include:

  - Attractiveness of plan provisions compared to what is available in the general marketplace to small plans.

  - Ability to commit resources of current plan to marketing activities conducted to "sell" the plan to local entities and potential drain on administrative resources.

- While Plan participation percentage is in line with that of other professionally marketed deferred compensation plans, as well as those in our sample above, it is important to monitor that participants who cannot afford to participate in the Plan are not induced to enroll. One sign of overly aggressive marketing is increased hardship withdrawals and inactive accounts. It is especially a concern when there is an enrollment force that is compensated at least partially on a commission or incentive basis.

- One of the signs of inappropriate enrollment is when the number of hardship withdrawals is higher than should be expected. In calendar year 1994, thirty-six hardships were requested and in 1995 that number had increased to ninety. We are advised by staff that there was no apparent common reason for the requests. It is not clear why the number of requests has increased so significantly in 1995. For its size, 96 withdrawals is high. We suggest that the State request input from DADCO to determine the cause.

Deferrals

- The average annual deferral for Plan participants in 1994 was $2,210 and in 1995 was $2,155. This average annual deferral is in line with other deferred compensation plans as evidenced below. It should be noted that plans with low participation rates frequently have very high deferral percentages, i.e., Delaware, New Jersey, Oklahoma, Virginia.

Plan	Average Annual Deferral 1993	Approximate Percentage of Participants
Alaska	$4,865	33
Arizona	2,155	43*
Arkansas	5,000	27
California	----	51
Colorado	2,607	19*
Connecticut	2,264	29*
Delaware	4,000	8*
Hawaii	2,350	43*
Illinois	2,900	21*
Indiana	1,988	28
Iowa	2,376	29
Kansas	2,147	37
Kentucky	1,723	7*
Louisiana	2,355	12*
Maine	2,636	30
Maryland	2,145	34
Michigan	2,719	69

Plan	Average Annual Deferral 1993	Approximate Percentage of Participants
Minnesota	2,315	26*
Mississippi	1,883	10*
Missouri	1,728	36
Montana	2,424	26
Nebraska	2,139	18
Nevada	2,660	35
New Hampshire	2,424	43
New Jersey	3,600	13*
New Mexico	2,084	37*
New York	3,629	27*
North Carolina	1,904	8*
Ohio	2,229	27*
Oklahoma	1,800	14
Oregon	3,220	26
Pennsylvania	2,400	17
South Dakota	1,732	14
Rhode Island	----	11
Tennessee	2,200	20*

Plan	Average Annual Deferral 1993	Approximate Percentage of Participants
Texas	2,400	4*
Utah	1,895	10*
Virginia	3,286	5*
Washington	2,834	28*
Wisconsin	2,275	28*
Wyoming	2,778	24*
AVERAGE	**$2,565.87**	**25.05**

Source: National Association of Deferred Compensation Administrators

- It is our understanding that contributions are fixed dollar amounts. We suggest the State consider changing to a percentage of payroll. The advantage is that a participant's contribution keeps pace with his or her salary and reduces the need for continual changes.

- There are generally two types of plan expenses charged to deferred compensation plan participants.
  - investment management fees
  - administration (including marketing) expenses
- Investment management fees are addressed under investment performance of variable annuity.
- In a bundled arrangement all of the services are provided by the investment providers and the fees collected by the providers reflect the level of services they are providing. In unbundled or hybrid arrangements, the investment providers may still collect all or a large portion of the fees and charges they would ordinarily collect but pay a TPA to perform some of the services they would ordinarily provide.
- Under the State's arrangement the investment provider (Nationwide) pays DADCO to provide marketing services but continues to provide most of the administrative services, including recordkeeping.
- Most fees and charges fall into two categories:
  - Disclosed--Fees that are deducted from a participant's account or are netted from the investment return after the return is declared (usually under variable investment options).
  - Undisclosed--Fees that do not appear as a deduction from a participant's account and are instead netted from the investment return before the investment return is credited to participant accounts (usually under fixed options).

Nationwide Investments--Fixed

- Because the SEC regulates mutual funds and insurance company variable annuity products, fees must be disclosed. Insurance company generate account products, such as the Nationwide Fixed Annuity, are not regulated by the SEC. These products are regulated by the Insurance Commissioner in each state. Insurance companies use the investment

"margin" on their general account to not only general profit and pay investment expenses, but also to cover all or a large portion of plan marketing, enrollment and administrative expenses. It only makes sense that if an insurance company charges approximately 1% for its variable fund (see below), it must deduct a similar amount from its fixed investment return.

- It is our experience is that the margin in most fixed annuity products, such as the State's, is between .50% and 1.00%. Note: The State's previous disclosed fee was .55% before it was converted to an undisclosed fee and likely did not represent total charges or allowances applied by Nationwide. This does not include .30% asset fee remitted to DADCO as commission payments. It is our understanding the State's fee is nettled out of the fixed account return after the credited rate is determined by Nationwide.

Nationwide Investments--Variable

- Since variable annuities (separate accounts) are regulated by the SEC, there is no ability to take a margin. Therefore, in variable annuity products, such as the Nationwide variable annuity, there are mortality, risk and administration charges. Mortality and risk charges supposedly exist to cover the risks associated with providing an annuity under the variable investment option. Under the Nationwide contract the amount collected for these services is .95%. There is also an administration charge which reflects the costs of maintaining participant account records and other operating costs.

- Nationwide assesses the 0.95% on participant accounts in the variable annuity and applies the State's administrative fee but but it is our understanding that it does not pay any of the cost for the DADCO commission charge from charges assessed to the variable accounts. The charge is only applied to the fixed annuity as an asset fee that reduces the credited interest rate. This means that the fixed annuity is bearing the total cost of marketing the Plan. Further, the variable annuity fee of 0.95% normally includes the cost of paying commissions to the marketing organizations. Nationwide should be applying the 0.30% charge to reduce its 0.95% fee.

Insurance Companies--Fixed and Variable

- In addition to the fees outlined above, many insurance companies also charge an annual administrative fee. Increasingly, insurance companies are eliminating this charge as the State has done.

- Insurance companies also frequently collect deferred sales charges on distributions or transfers. Nationwide has eliminated this charge for Plan benefit payments. It will also be eliminated on the Plan level (applied on contract termination) at the end of 1996.

- It is our opinion that the fee structure for the Plan is reasonable and the State has taken appropriate action in the past to obtain a competitive fee structure. As indicated elsewhere in this report, our suggestion would be for the elimination of the annuity structure of the fixed and variable investment products which would reduce overall expenses. In particular the variable annuity product is expensive because the variable expense charge is collected in addition to the retail mutual fund administrative charges for the funds offered therein. Note: A change to the use of non-wrapped mutual funds may require a change to State law as appears the law restricts investments to savings accounts or annuities.

Administrative Cost

- A .10% fee is deducted from participant accounts and is used by the State to offset its costs of operating the Plan. The fee totaled about $24,000 in 1995. Plan sponsors are increasingly collecting such fees to cover the costs of monitoring and overseeing their plans. As the assets in deferred compensation plans increase the responsibility of overseeing investment selection plays a larger role. We recommend that the State continue to collect a fee that permits it to adequately fund its oversight and monitoring of the Plan

Marketing Cost

- DADCO receives commissions based on the following:

- In 1995, the cost of commissions paid to DADCO was $245,000. This amounts to about $45 a participant (active and inactive but not in pay status) or .22% of assets. Based on an average plan administrative expenses of .95% this payment represents less than 25% of total plan administrative costs (exclusive of plan oversight expenses).

Commission Type	Rate
1st year/reinstatement after 5 years	8.25% of annual contribution
Ongoing Service Fee	2.30% of annual deferrals

- This indicates that the Plan is maturing with new enrollments (which represent a higher rate of commission payment) representing a smaller portion of the marketing cost. This hypothesis is born out by the fact that first year commissions paid in 1995 represented 29% of total commission payments. In addition, the absolute number of new enrollments has been declining. There were over 1,000 new enrollments in 1993, less than 800 in 1994 and about 500 in 1995 (estimated).

- Based on this decline in new enrollment activity we suggest that the State explore the possibility of focusing more attention on education and service and restructuring the DADCO service and compensation arrangement to facilitate this approach.

- A maturing plan like the State's may be in a position to take advantage of less labor intensive marketing methods such as:

  - direct mail,
  - video tapes,
  - interactive communication.

- Overall Plan costs are reasonable when compared to other plans, although changes to the various investment components could reduce costs as indicated later in this report.

Description of Current Services

- DADCO:

  - Enrolls new participants
  - Counsels participants
  - Conducts group and one-on-one enrollment sessions
  - Explains Plan investment options and operation of Plan.

Adequacy

- DADCO has two benefit plan executives (enrollers). This equals approximately one enroller for every 6,500 eligible employees (excluding education employees) or 2,000 participants. We have assumed that the manager is not an enroller.

- Based on our experience in the industry, this ratio is in line with other full service marketing organizations, although toward the low end of the scale. It is interesting to note that the self-marketed Plans of California, Michigan and Washington employ few if any enrollers yet have high participation percentages. All people involved in marketing in these states are full-time state employees.

Compensation

- Account executives are paid by DADCO under a salary and incentive bonus arrangement. The incentive is based on sales and persistency renewal premiums. The average incentive amounts to 50% of an enroller's total pay.

- In the deferred compensation industry 100% commissioned sales force arrangements are not uncommon in bundled arrangements delivered by insurance companies. This was the structure in place during the few months that PEBSCO handled the Plan's marketing. Recently, however, some of the larger independent TPAs have moved to

salary/incentive arrangements such as DADCO's. Compared to those companies in which an enrollee's incentive bonus may average between 10% and 40% of compensation, DADCO's payment structure at 50% is slightly higher than the norm.

- Salaried enrollers, while almost unheard of ten years ago, are becoming increasingly popular with plan sponsors. California, Michigan and Washington, which market their plans themselves, all pay their marketing personnel on a salary only basis. The Commonwealth of Massachusetts, which uses an independent marketing force as Montana does, has requested that its TPA compensate its enrollers on a salaried basis.

- We suggest the Council consider whether to decrease reliance on incentive payments.

Quality

- Account executives are full time employees of DADCO and work exclusively on the Plan. They can not sell ancillary products. DADCO account executives are licensed by the Montana Department of Insurance and have passed a NASD Series 7 exam. These are appropriate qualifications based on our experience in the deferred compensation market.

- It appears based on interviews and review of materials that DADCO is committed to providing a high level of service to the State's plan.

Marketing Process

- DADCO follows normal procedures and methods, including group and individual meetings and enrollers use a lap top computer to model tax savings and account balance growth.

- The enroller uses a lap top computer when meeting with participants. The laptop provides payroll illustration and account balance projections. The laptop can also generate a completed enrollment form which improves the legibility of enrollment forms and reduces errors. The State may also want to explore the administrative and legal implications of automatic transmission to the recordkeeper of enrollement forms.

- DADCO relies very heavily on individual meetings with an enroller. Meetings held at the work location are primarily educational sessions held at department and agency staff meetings. A business reply card is used by DADCO to facilitate setting up individual meetings.

- The use of group presentations is relatively limited. Typical group meetings held at work locations are not used to the degree that we have seen them used by the marketing organizations in other deferred compensation plans. We do not have enough information to make a determination that the heavy reliance on individual meetings is the most effective technique to use; however, DADCO believes that its approach best fits the State's circumstances.

- To compensate for the lack of group meetings, we suggest the State explore video enrollment. This approach provides a consistent and easily accessed message. It can also be expanded to include tapes on investment education and retirement planning topics that can enhance DADCO's strong one-on-one service approach. With the State's population it can also increase the accessibility of information for employees in remote locations.

  The advantages of videotapes include:

  - Ensures that all employees receive the same message.
  - Enables employees to view tape at a time that is convenient to them.
  - Family members can also view the tape.
  - Use of communication methods that are particularly effective and professional communicators.
  - High employer identification with message especially if actual employees are used in the video.

  The disadvantages include:

  - Difficult to include time sensitive information such as investment performance.
  - No ability to interrupt with questions. Questions must be held to the end of the tape and asked during a question and answer session or at a later meeting with an enroller.

- Increasingly, deferred compensation plans are providing retirement planning services (other than account balance projection and life expectancy calculations). Based on review of marketing materials it appears that investment education is not as comprehensive as it could be. This may well be the result of having too many investment options, as well as DADCO's lack of a large home office to support an investment in such communication activities.

- We also suggest the Plan consider a life style or life cycle fund that introduces the need for variable investment without placing account executives in the position of having to persuade employees to invest in variable investments and perhaps being viewed as too aggressive. This fund could be used to replace some of the many funds currently existing within the Plan. Note: This recommendation may likely require the "unwrapping" of the Nationwide variable annuity.

- It has been our experience that the helpfulness of human resources staffs vary considerably and that the success of a plan is dependent on the support of managers and human resources staff. Where possible, the State should work on garnering support at the various departments and plan outreach and educational sessions with department and agency heads. Like every marketing organizations, DADCO has had the experience of every marketing force of having difficulty in obtaining access to potential participants.

Marketing Plan and Report

- DADCO's business plan is long on ideas and short on goals. We suggest that the Plan's marketing plan set goals and objectives for DADCO. Proposed reports should be submitted to the Council at the end of the calendar year for the next year's activity. The goals of the marketing plans should be used to set the performance measures for DADCO's marketing activity.

- There are many worthwhile suggestions in the marketing plan; however, the total seem, in the aggregate, a little difficult to accomplish. Our comments on specific components of the marketing plan are:

    - "Finalize the investment profiling tool." While the investment profiling tool is helpful, a lifestyle fund or other mixed investment medium would make this tool much more useful. Asking the participant to look at his or her "profile" and select an appropriate investment mix out of 37 investment options is a little difficult to achieve. It is also difficult to get the participant to focus on non-fixed account investments at all.

- "Coordinate benefits fairs and monthly schedule of on campus service days." Should so much emphasis on be placed on marketing in the educational system?

- "Seek an invitation to participate in retirement planning sessions." We suggest that the State explore this possibility.

- "Mailing campaign that would target non-participating employees, especially in agencies with low participation rates." We suggest that the State explore this possibility, although video communication may be a more effective approach.

- "Obtain approval to attend new employee orientation." Assuming this is feasible with only two enrollers, we suggest that the State explore this possibility.

- "Prepare overview material that payroll would be able to give new employees." We suggest this be given some priority since the material we received that was identified as materials that were distributed by the payroll department were out of date. There was a reference to 25 investment options and a $12 annual administrative fee.

- "Referral request system": We would not suggest that this be a high priority.

- "Continue use of business reply cards." The use of these cards gives employees an easy method of authorizing program changes. Completing and signing the card is all a participant needs to do to initiate changes to deferral amounts. We think this is an excellent use of marketing resources; however, the State should consider adding language since the change is an election to forego current salary and has legal and tax implications.

Current Arrangement

- Under the current arrangement, administration of the Plan is the shared responsibility of DADCO and Nationwide. DADCO maintains some employee data on an internally developed system. This information is used to conduct the payroll reconciliation. Nationwide maintains all the participant and Plan financial records, although it is our understanding that it does not maintain salary deferral information. This explains why participants can use Nationwide's voice response system to change the investment direction of future deferrals and move assets from one investment fund to another but cannot change future deferral elections.

- We would suggest that consideration be given to exploring what steps need to be taken to change this arrangement to permit the full use of voice response capabilities.

- A pronounced trend among large Section 457 plans has been the move toward unbundled service arrangements. These arrangements have allowed plan sponsors to use the volume of their assets to negotiate fee improvements. Sponsors are also able to select providers based on their expertise in a specific service area rather than a package of total service.

  One aspect of this trend toward unbundling has been the move to use an independent recordkeeper. The use of an independent recordkeeper has allowed plans to uncouple recordkeeping from investment management. It also allows a plan sponsor greater latitude in selecting and removing investment options since the recordkeeping function is not involved. In addition, as recordkeeping has grown more sophisticated, systems can handle different investment options, such as unrelated mutual funds, with same day or next day exchange available regardless of whether funds are offered within the same family.

- Mutual funds have also begun to allow for negotiation of fund fees. Many funds will agree to refund a portion of their fees in recognition of marketing (Section 12 b (1)) or administration services performed by another party. These refunds can be used to offset the recordkeeper's fees. This approach allows the plan sponsor to receive a refund that increases as assets grow assets and offsets a relatively stable recordkeeping cost.

- Uncoupling the State's current recordkeeping function from the investment provider will allow for the negotiation of fees. It will also allow the Council to use institutional mutual funds. These provide for comparable funds at a much lower price.

  For example, of the current mutual funds offered under the Nationwide Variable Annuity we believe that all but Seligman and Nationwide will agree to offer a refund on their fees. Based on our experience we believe that were the State to request fee reimbursements these would create an average 0.17% reduction from the current level of expenses. In the State's plan, if we apply this average to the December 31, 1995 market value of variable funds, this would generate $32,000 annually. This reduction could be applied to offset the cost of administering the Plan. Note: The service structure would need to contain a broker/dealer arrangement to receive the refunds.

- Written explanatory letters were well written and clear. For some of the letters the State may want to consider a larger type face, although it will lengthen letters, the ease of readability, especially for older employees, will be appreciated.

- In our review of the participation agreement, it appears that there is an error on the back of the form that indicates that a change is "increase or decrease in moving an account value." We suggest this be cleared up at the next reprinting of the form.

- The memorandum of understanding indicates that the 33-1/3% maximum equals 23.5% of the participant's gross income. This is normally communicated as 25%. The memo of understanding also indicates that an automatic default date occurs if a benefit commencement date is not selected within the time limit required after separation from service but it does not indicate what the date will be. Since it is defined in the Plan document as immediate distribution, we see no reason this should not be included on the form.

- The memo of understanding also indicates that participants have the choice of beginning to receive distributions at age 70½ if they are still working or delaying receipt. Although a conservative interpretation, giving participants the choice could be construed as creating a constructive receipt issue since the determination of whether or not to receive the income is in the control of the employee. We suggest that the Plan document delay distribution to employees who are still working to avoid this possibility.

- The memo of understanding refers to the participant's ability to make exchanges at any time (from; variable to variable, variable to fixed, or fixed to variable); however, there is a 10% aggregate plan transfer limit on the fixed fund. Although the likelihood of having to enforce an aggregate limit is remote, we suggest that reference should be made to this possibility.

- The payout form indicates that employment with the "Plan Owner" has or will terminate. It seems that more user friendly language can be used here. For example the form uses the language: "Your account is removed from the Administrator's Assumulation System and your account balance is used to purchase an annuity... " It also does not indicate what is required for proof of date of birth.

- The Future Payout Date Election Form indicates that once the payout date has been selected it cannot be changed. Note: It can be changed due to an unforeseen financial hardship as indicated on the Participation Agreement. It also indicates that "If you do not specify a payout date, you will be in violation of federal IRS regulations and may be subject to IRS tax penalties." This is not strictly true since the default option comes into play which, according to the Plan document is immediate payout. We suggest the form be amended to clarify this unless there are overriding reasons to the contrary.

INVESTMENT OPTIONS

Number of Options

- The Plan as currently structured allows new participants to choose among 38 investment options. The 1993 survey by the National Association of Government Deferred Compensation Administrators (NAGDCA) of state deferred compensation plans showed of the 40 responding, an average of 22 investment options. If Texas was excluded (it has 250 options), the average drops to 16. This is significantly higher than experienced in the Section 401(k) marketplace. It is our opinion that there are too many investment options in the Plan. In fact, there are many funds with small amounts of assets and to which only a small portion of total deferrals is directed even with the increase in the percentage of deferrals to variable options.

- Participants in 1995 deferred 78% of contributions to the Nationwide fixed annuity. For all the variety of investment options offered, there are only 6 funds to which participants have directed 1% or more of deferrals. Deferrals to all other funds in total only represented 9% of the deferrals in 1995. The 6 selected represented the funds with good performance and/or name recognition. Clearly participants in the Plan have not availed themselves of the the broad spectrum of funds. See chart on page 46.

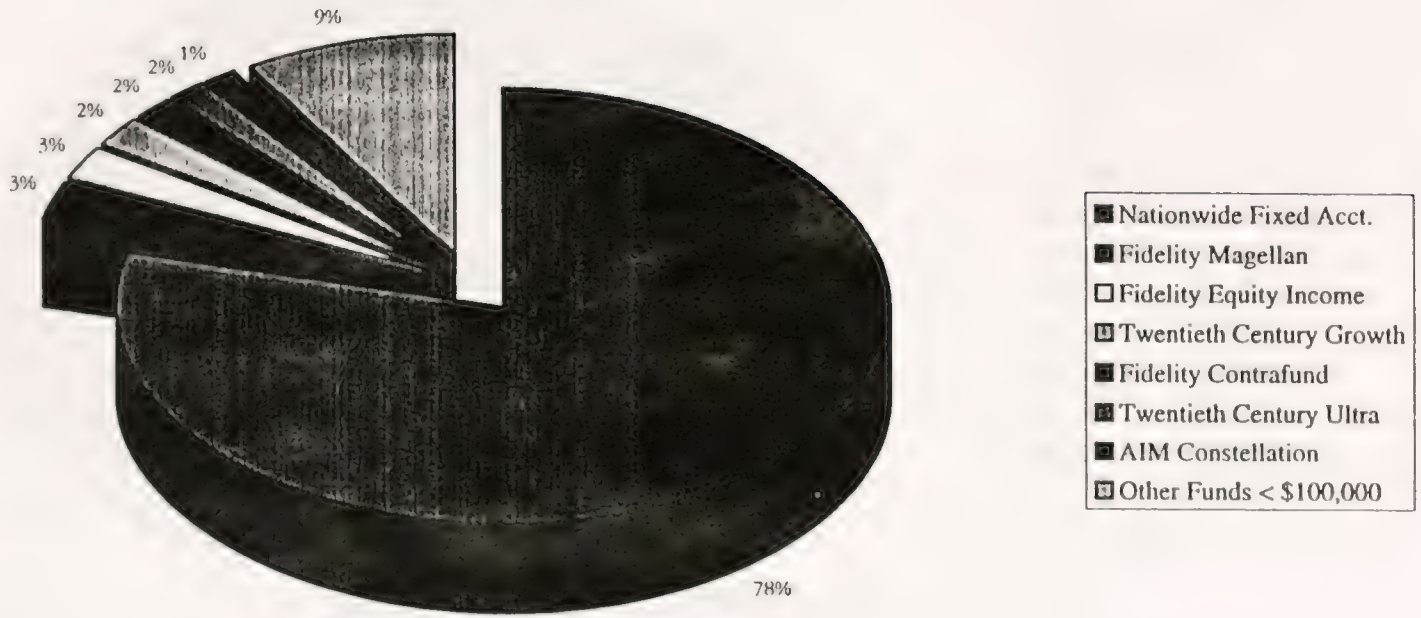
- The large number of variable funds is particularly inappropriate since participants defer almost 78% of total contributions to the fixed investment options. While deferred compensation plan participants are often very conservative investors; a large number of investment choices may serve to confuse participants and decrease the likelihood that they will invest in a variable option.

- We also recommend the State consider establishing investment objectives and standards for the Plan's variable options. Performance of funds should be measured against these standards. If a fund fails to perform the State can then consider whether it should continue to be offered. To avoid the necessity of freezing funds the participants could be advised of these standards in advance and that, in the event a fund must be deleted, its assets will be moved to a comparable new fund. We suggest that the State consider having an independent party assist in establishing these standards and criteria. We also suggest that ongoing monitoring of these standards also be provided by an independent party.

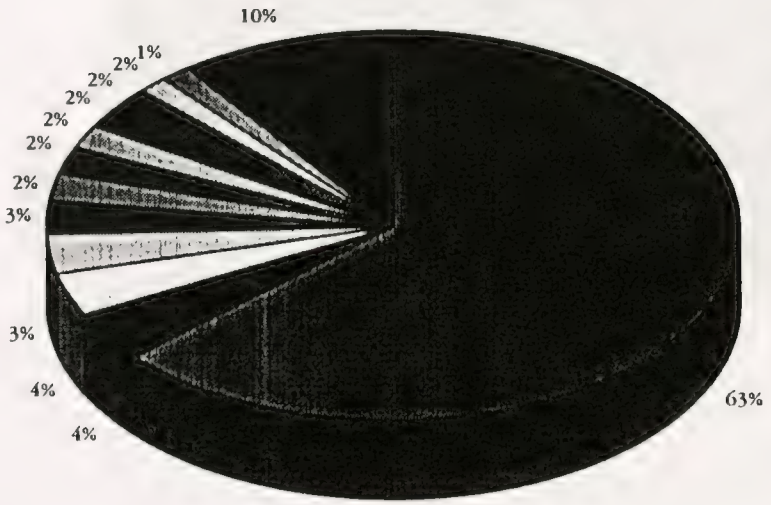
- As shown in the Investment Performance section the performance of the funds offered varies widely even with funds in the same asset category. We believe that the Plan would be more beneficial for participants if the number of funds offered in each category was reduced and investment guidelines were employed to assure participants of a choice of above average investment funds.

- As mentioned earlier, life cycle, life style, or asset allocation options are gaining popularity in defined contribution plans in general. These allow the participant to avoid the confusion of selecting from a multiple of funds. It also makes the enroller's job of explaining options easier and can facilitate the participants inital consideration of a variable option. The Plan currently does not offer any such fund and it may wish to consider such an approach. If the number of variable funds were reduced it would be possible to create several investment portfolios of funds offered based on different investment objectives. These portfolios could, therefore, represent a blend of all of the funds offered.

1995 Deferrals by Fund

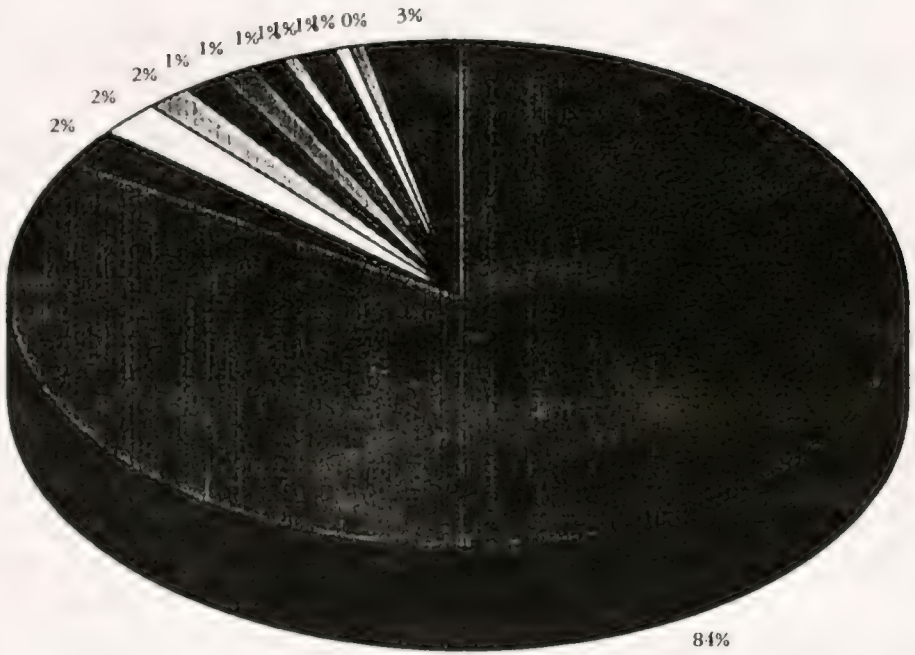


1995 Fund Participation



- Nationwide Fixed Acct.
- Fidelity Magellan
- Fidelity Equity Income
- Twentieth Century Growth
- Twentieth Century Ultra
- Fidelity Contrafund
- Fidelity Growth & Income
- T.Rowe Price International
- MFS Growth Opportunities
- Templeton Foreign
- Putnam Investors
- Putnam Voyager
- Other Funds <100 Participants

1995 Fund Balances



- Nationwide Fixed Acct.
- Twentieth Century Growth
- Fidelity Equity Income
- Putnam Investors
- MFS Growth Opportunities
- Fidelity Magellan
- Twentieth Century Ultra
- AIM Constellation
- Fidelity Contrafund
- Fidelity Growth & Income
- Nationwide Fund
- T.Rowe Price International
- Other Funds <$500,000

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FIXED PRODUCT - INVESTMENT PERFORMANCE

➢ Using our product database and experience in the industry, we compared the rates and crediting methods used by Nationwide to a sample of the following other products customarily provided in the Section 457 and TSA market for which we currently have updated rates. The rates, fees and charges used may vary among cases depending upon their individual pricing. These expenses and rates should be viewed as representative.

- ❖ Aetna Life Insurance Co.
- ❖ American United Life
- ❖ Equitable Life Assurance Soc.
- ❖ Great-West Life & Annuity
- ❖ Hartford Life Insurance Co.
- ❖ Kemper Investors
- ❖ Lincoln National
- ❖ Metropolitan Life Insurance
- ❖ Prudential Life Insurance Co.
- ❖ The Travelers Insurance Company
- ❖ UNUM Life Insurance Co.
- ❖ VALIC

➢ To evaluate the competitiveness of the fixed product offered by Nationwide, we simulated contributions to its product to match those made by the other carriers. This simulation allows us to compare the product with those of other national insurance companies. Without simulating contributions it is very difficult to compare rates on a comparable basis because carriers use different methods to determine interest rates.

For example, some carriers credit rates on a new money/portfolio basis, like Lincoln National, or a banded portfolio basis like the Kemper II product, or use a number of other interest crediting methods. Using historical rates and interest crediting policies, we can draw comparisons between products.

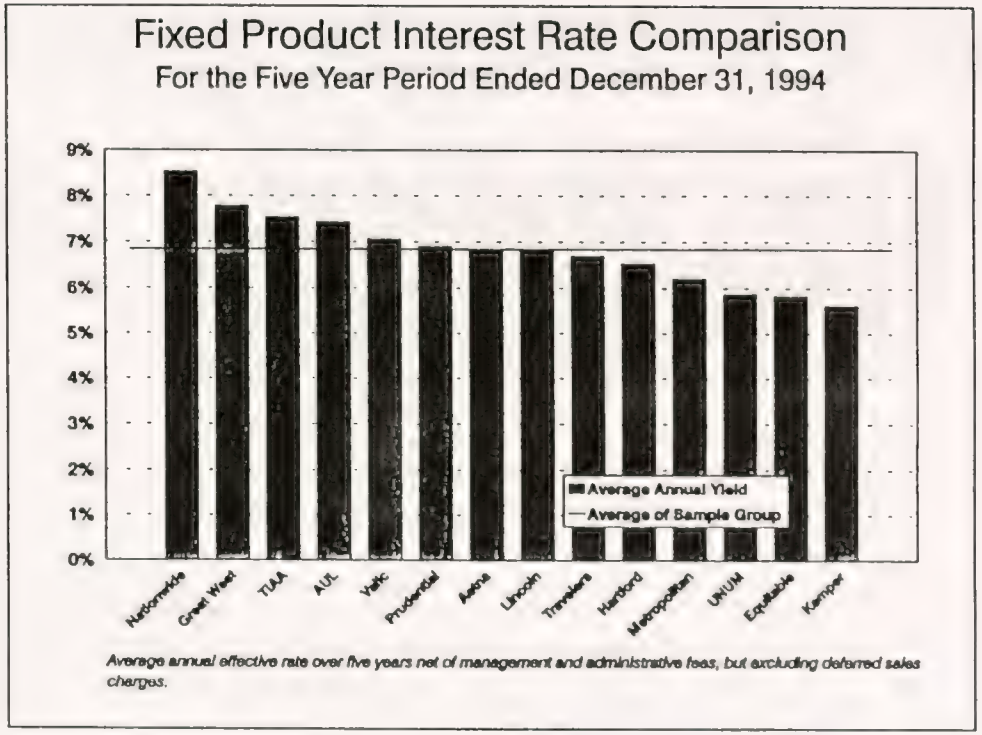
➢ To compare different fixed products on a comparable basis, we simulated contributions to each product over a five year period. Assumptions for the comparison were:

- ❖ $200 deposited at the beginning of each month, from January 1990 to December 1994 (1995 information was not available).

- ❖ All management fees, expense and administrative charges and front-end sales charges are deducted from gross interest. Annual administrative fees were not deducted due to the possibility of multiple accounts.

➢ The following are the computed net annual effective rates of return for each product (listed in order, highest to lowest:

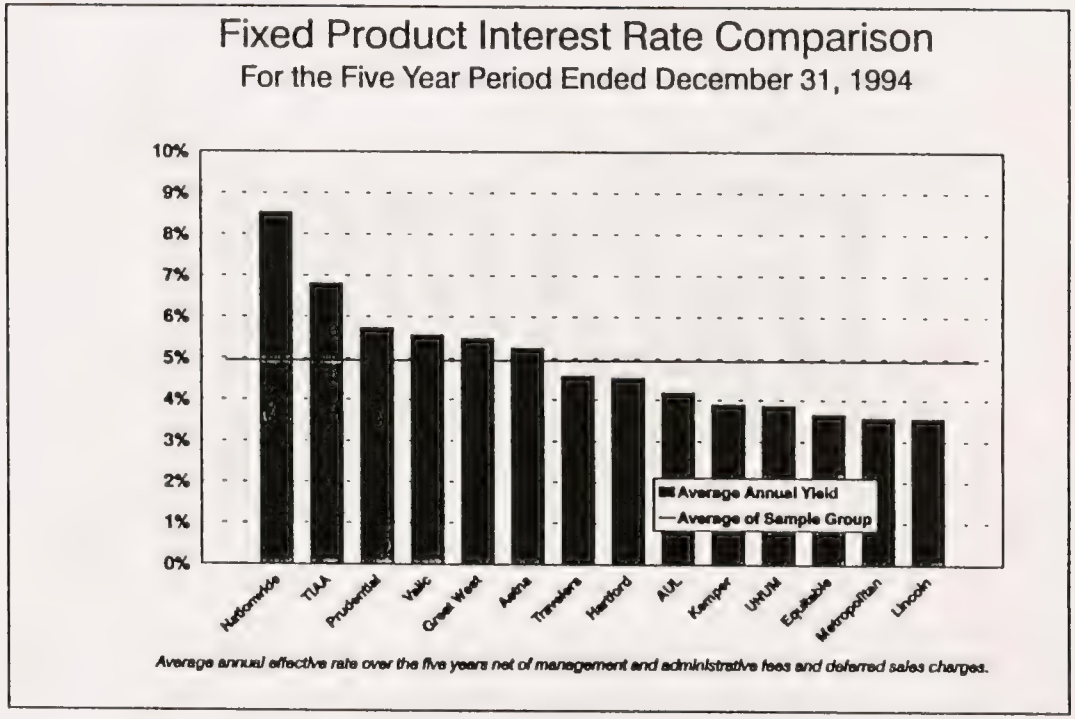
Carrier	Interest Rates
Nationwide	8.54%
Great-West	7.79%
TIAA	7.54%
AUL	7.43%
VALIC	7.06%
Prudential	6.91%
Aetna	6.82%
Lincoln	6.82%
Travelers	6.71%
Hartford	6.54%
Metropolitan	6.21%
UNUM	5.88%
Equitable	5.84%
Kemper	5.63%



- Deferred sales charges were applied to each of the fourteen products' simulated balances as of December 31, 1994 to compute the following rates of return. It was assumed that all money accumulated from January 1, 1990 to December 31, 1994 was withdrawn on December 31, 1994.

- The rates, listed from highest to lowest:

Carrier	Interest Rates
Nationwide	8.54%
TIAA	6.81%[1]
Prudential	5.73%
VALIC	5.56%
Great-West	5.47%
Aetna	5.24%
Travelers	4.58%
Hartford	4.54%
AUL	4.18%
Kemper	3.90%
UNUM	3.87%
Equitable	3.66%
Metropolitan	3.58%
Lincoln	3.56%



- Nationwide's interest rate credited to its fixed annuity account has been very competitive. The elimination of the participant level deferred sales charge also improves its ranking compared to the other fixed products which pay commissions and, therefore, impose a deferred sales charge to recover their advanced commissions.

FIXED PRODUCT - CREDIT QUALITY

- Nationwide is highly rated by three of the recognized credit rating agencies. Currently the carrier is rated A+ by A.M. Best, AAA by Standard & Poor's, and Aa1 by Moody's. The carrier is not rated by Duff & Phelps, another major rating agency. A rating of A+ is the second highest a company can receive from A.M. Best, and is considered by Best to be a superior rating. An AAA rating is the highest claims-paying ability rating a company can receive from Standard & Poor's. A rating of Aa1 is the second highest given by Moody's Investors Service, and is considered by Moody's to be an exceptional rating. Nationwide was downgraded from Aaa to Aa1 by Moody's on January 23, 1992, primarily due to long-term competitive and regulatory pressures. The ratings agencies, by way of the ratings applied to Nationwide, believe Nationwide has demonstrated a strong ability to meet its policyholder and other contractual obligations, and offers superior financial security relative to its peers in the life insurance industry. Nationwide is currently on credit watch by both Standard & Poor's and Moody's.

- Along with applying a credit quality rating to an insurance company, A.M. Best also places the company in a "Financial Size Category." The Financial Size Category is an indicator of the size of an insurer and is based on reported policyholders' surplus plus conditional or technical reserve funds, such as asset valuation reserves (AVR). The Financial Size Category is represented by Roman numerals ranging from Class I (the smallest)) to Class XV (the largest). Nationwide falls into Financial Size Category XIII, reflecting an adjusted policyholders' surplus of $1.396 billion. The adjusted policyholders' surplus for this Financial Size Category ranges from $1.25 billion to $1.50 billion.

- The recent failures of Executive Life and Mutual Benefit have highlighted the importance of continued monitoring of the creditworthiness of fixed annuity providers. The primary consideration when evaluating fixed products is the creditworthiness of the underlying insurance company. In this regard, Nationwide Life Insurance Company is a very high quality carrier.

  We recommend that when selecting fixed annuity carriers that plan sponsors select high quality companies. There is no advantage in using a carrier with a lower credit rating when the same product can be obtained from a highly rated company. Using highly rated companies will reduce the Plan's credit risk.

- Interest rates are a secondary consideration to credit quality when evaluating fixed products. The variance in interest rates credited between the highest and lowest yielding products result in only marginal differences in accumulated account balances.

- We recommend the State establish credit quality standards for the fixed investment option. These standards would set minimum credit quality rankings that an investment must satisfy to be part of the Plan. Standards for selection may be higher than for retaining an existing investment option. Since the Plan is a creditor of the current General Account fixed annuity it is important that the Council monitor its credit ratings.

Fixed Annuity Credit Quality

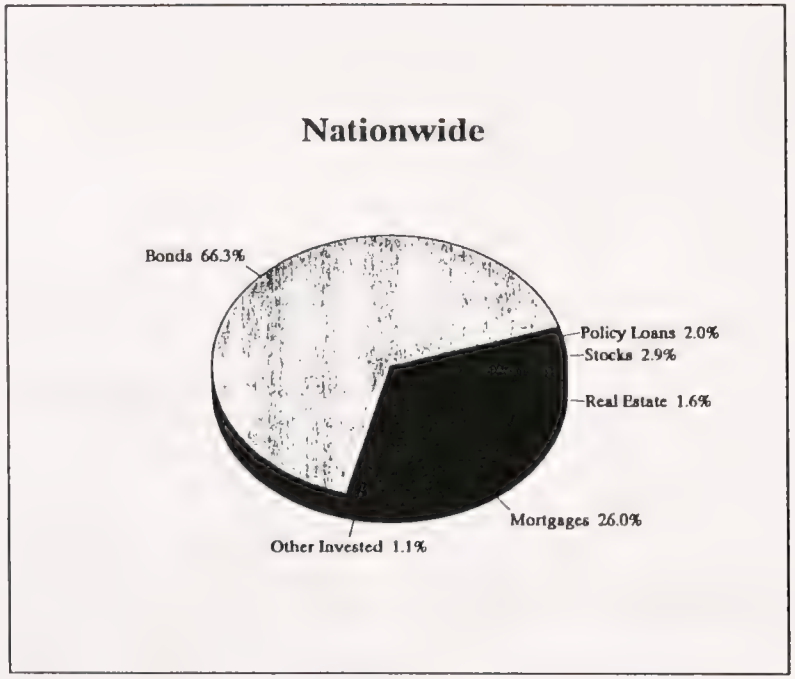
	Public Credit Ratings as of February 15, 1996					Non-Investment Grade Bonds as a % of Invested Assets[1][3]	Problem Real Estate as a % of Invested Assets[1][3][4]	Adjusted Capital & Surplus as a % of Invested Assets[1][3]
	A.M. Best's	Best's Financial Size	Standard & Poor's	Moody's	Duff & Phelps			
Nationwide	A+	12	AAA[N]	Aa1[N]	N/R	1.4%	0.6%	9.1%

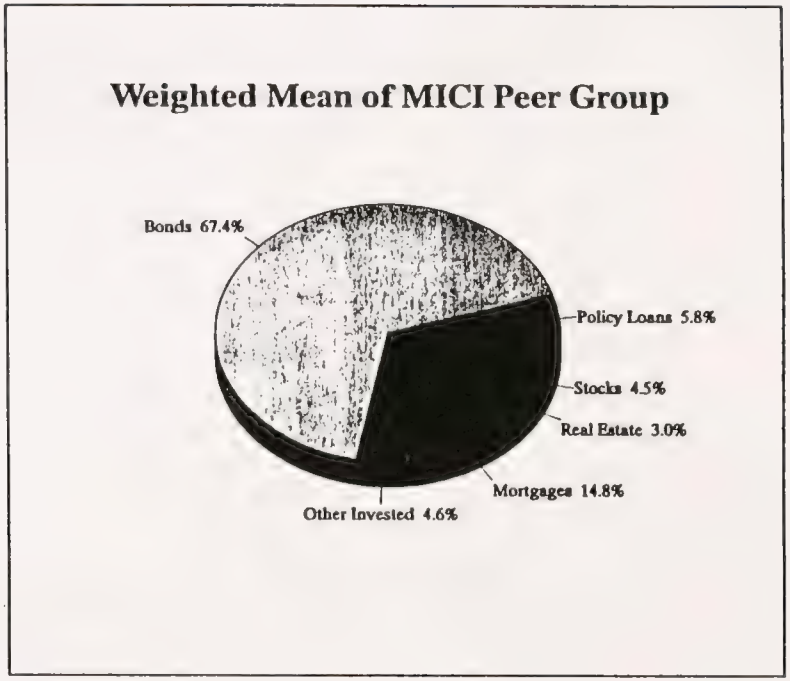
N/R = Not rated

(D) Credit Watch (developing trend)
(N) Credit Watch (possible downgrade)
(R) Under Review
(1) As of December 31, 1994.
(2) Problem real estate is defined as non-performing mortgages and/or real estate acquired in default.
(3) Data Source: The National Association of Insurance Commissioners, by permission. The NAIC does not endorse any analysis or conclusions based upon the use of its data.

DISTRIBUTION OF INVESTED ASSETS

As of December 31, 1994





*The peer group is comprised of the 193 largest life insurance companies based on invested assets.

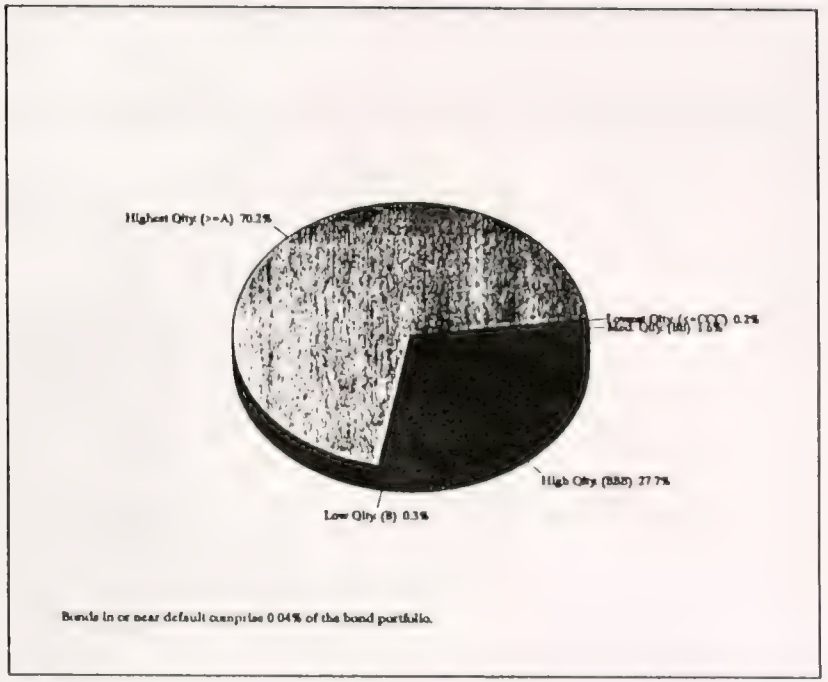
The distribution of Nationwide's invested assets on December 31, 1994 was very similar to the weighted average peer group's distribution, with a higher allocation to mortgages and slightly lower allocations to stocks, real estate, policy loans, and other investments.

Data Source: National Association of Insurance Commissioners, by permission. The NAIC does not endorse any analysis or conclusions based upon the use of its data.

FIXED PRODUCT - BOND PORTFOLIO OF NATIONWIDE'S GENERAL ACCOUNT

Distribution of Credit Quality
As of December 31, 1994

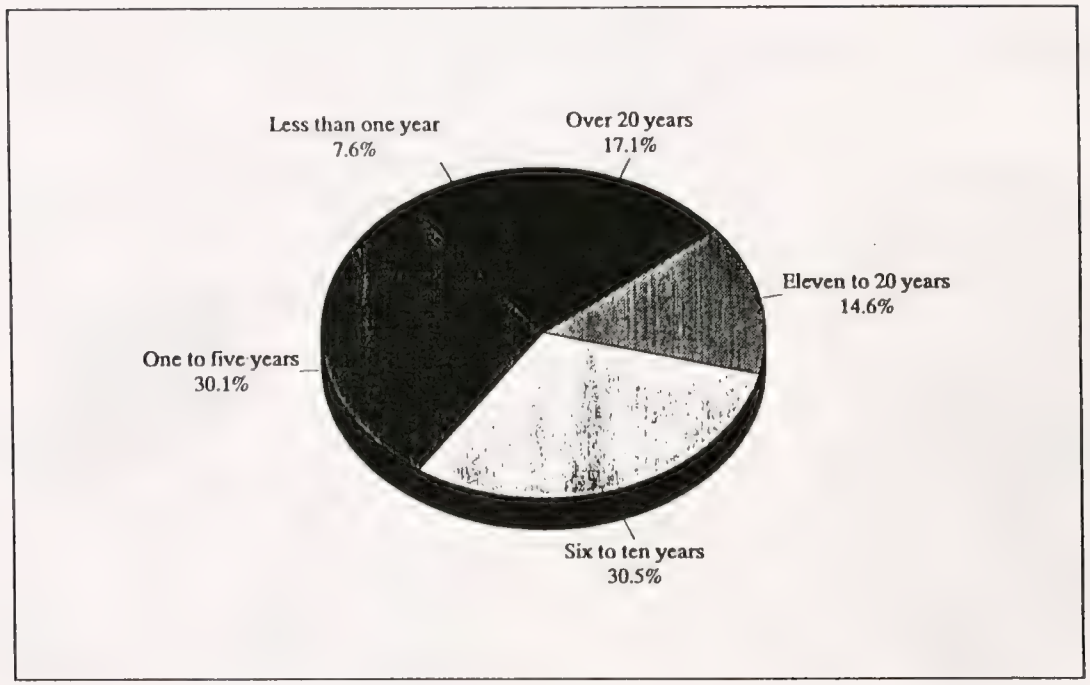
Quality Category	Dollar Amount (in millions)
Highest quality bonds (AAA-A)	$ 7,183
High quality bonds (BBB)	$ 2,828
Medium quality bonds (BB)	$ 159
Low quality bonds (B)	$ 29
Lowest quality bonds (CCC or less)	$ 22
In or near default	$ 4



Approximately 98% of the bond portfolio of Nationwide's General Account was invested in investment grade bonds as of December 31, 1994. Of the below investment grade (junk) bonds, 74% was medium (BB) quality.

Data Source:National Association of Insurance Commissioners (NAIC), by permission. The NAIC does not endorse any analysis or conclusions based upon the use of its data.

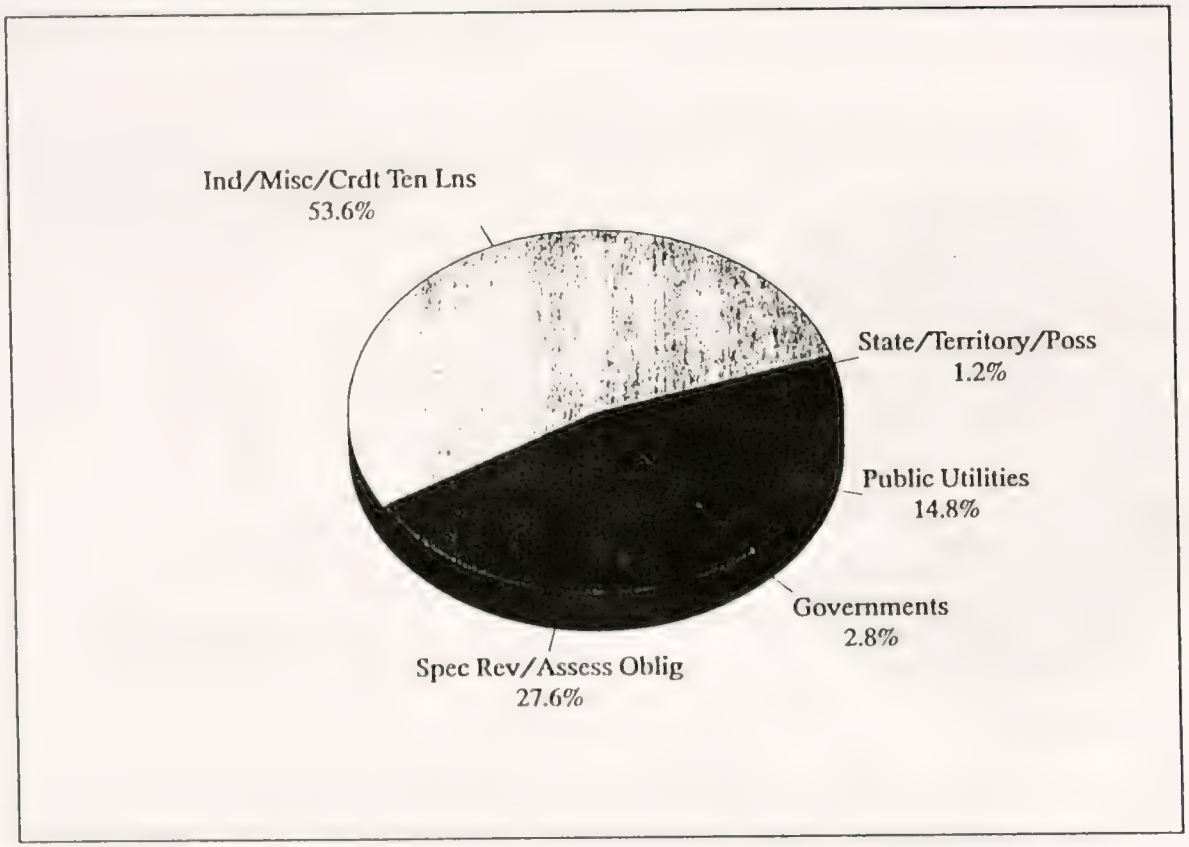
Bond Portfolio of Nationwide's General Account
Maturity Structure
As of December 31, 1994



The maturity structure of the bond portfolio is fairly evenly distributed among all maturities. Approximately 60% of the bonds mature in one to ten years.

Data Source:National Association of Insurance Commissioners (NAIC), by permission. The NAIC does not endorse any analysis or conclusions based upon the use of its data.

Bond Portfolio of Nationwide's General Account
Sector Diversification
As of December 31, 1994

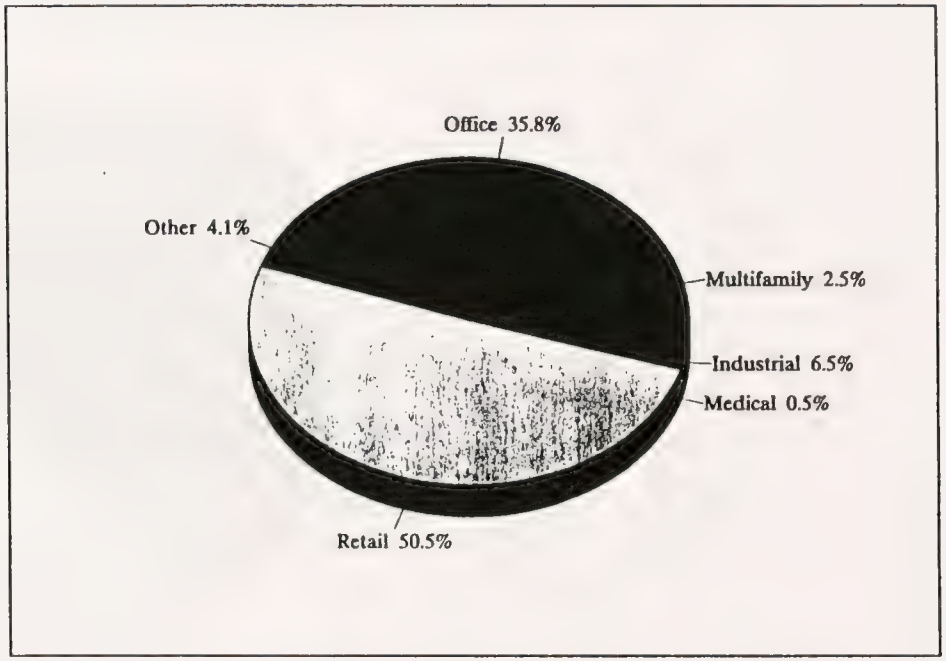


Data Source: Nationwide

FIXED PRODUCT - REAL ESTATE PORTFOLIO OF NATIONWIDE'S GENERAL ACCOUNT

Diversification by Type of Property
As of December 31, 1994

Type of Property	Dollar Amount (in millions)
Industrial	$ 17
Medical	$ 1
Multifamily	$ 7
Office	$ 96
Other	$ 11
Retail	$ 135

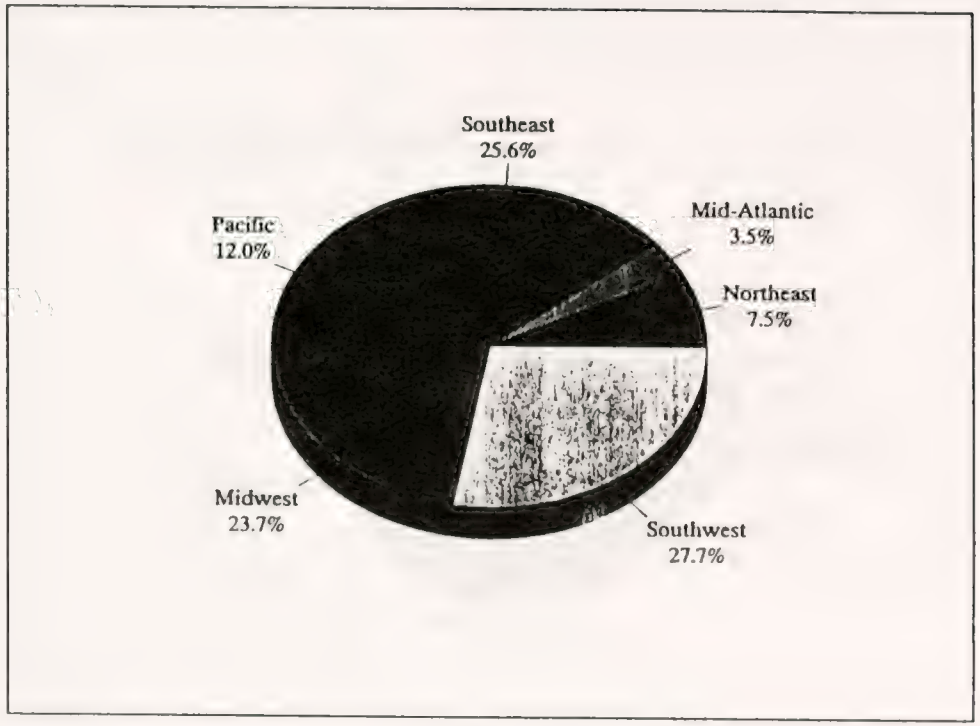


The real estate portfolio of Nationwide's General Account is heavily invested in office and retail properties. We are advised by Nationwide that the real estate portfolio represents properties received as a result of mortgage defaults rather than an active investment approach.

Data Source: Nationwide

Real Estate Portfolio of Nationwide's General Account
Diversification by Geographic Region
As of December 31, 1994

Region	Dollar Amount (in millions)
Northeast	$ 20
Mid-Atlantic	$ 9
Southeast	$ 68
Midwest	$ 63
Southwest	$ 74
Pacific	$ 32



The real estate portfolio has a relatively small exposure to the Northeast and Mid-Atlantic states (11% combined for both regions). The portfolio reflects the regions of defaulted mortgages held by Nationwide.

Data Source: Nationwide. Analysis by MICI.

FIXED PRODUCT - MORTGAGE PORTFOLIO OF NATIONWIDE'S GENERAL ACCOUNT

Diversification by Type of Property
As of December 31, 1994

Type of Property	Dollar Amount (in millions)
Shopping Centers	$ 1,974
Apartments	$ 741
Warehouse	$ 539
Office Buildings	$ 500
Medical Facilities	$ 146
Retail Buildings	$ 77
Industrial	$ 24
Miscellaneous	$ 6
Residential (1-4 family)	$ 4
Hotel & Motel	$ 2

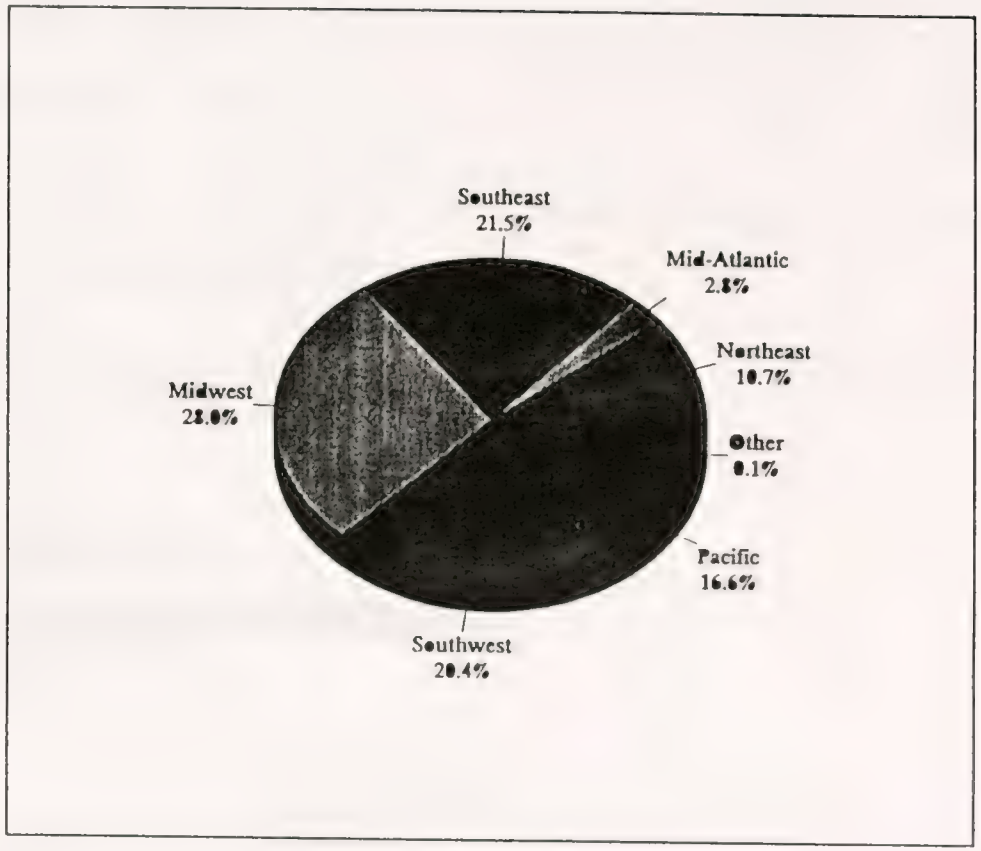
Hotels & Motels comprise 0.04% of the mortgage portfolio.

Almost 50% of Nationwide's mortgage portfolio is invested in shopping centers.

Data Source: Nationwide.

Diversification by Geographic Region
As of December 31, 1994

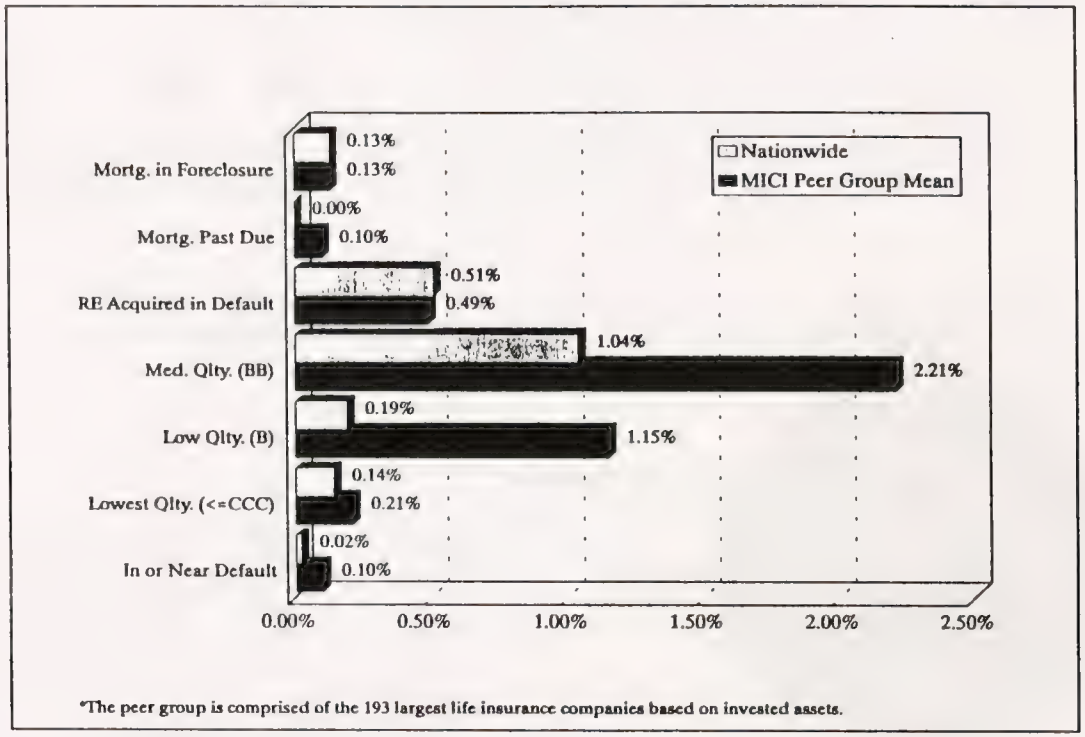
Region	Dollar Amount (in millions)
Northeast	$ 428
Mid-Atlantic	$ 111
Southeast	$ 865
Midwest	$ 1,124
Southwest	$ 665
Pacific	$ 819
Other	$ 3



The mortgage portfolio has a relatively small exposure to the Mid-Atlantic states (2.8%).

Data Source: Nationwide. Analysis by MICI.

Nationwide Versus MICI Peer Group Mean*
As of December 31, 1994



The high risk asset categories shown in this graph are all below or near the MICI peer group mean. Junk bonds are well below the peer group mean.

Data Source: National Association of Insurance Commissioners, by permission. The NAIC does not endorse any analysis or conclusions based upon the use of its data.

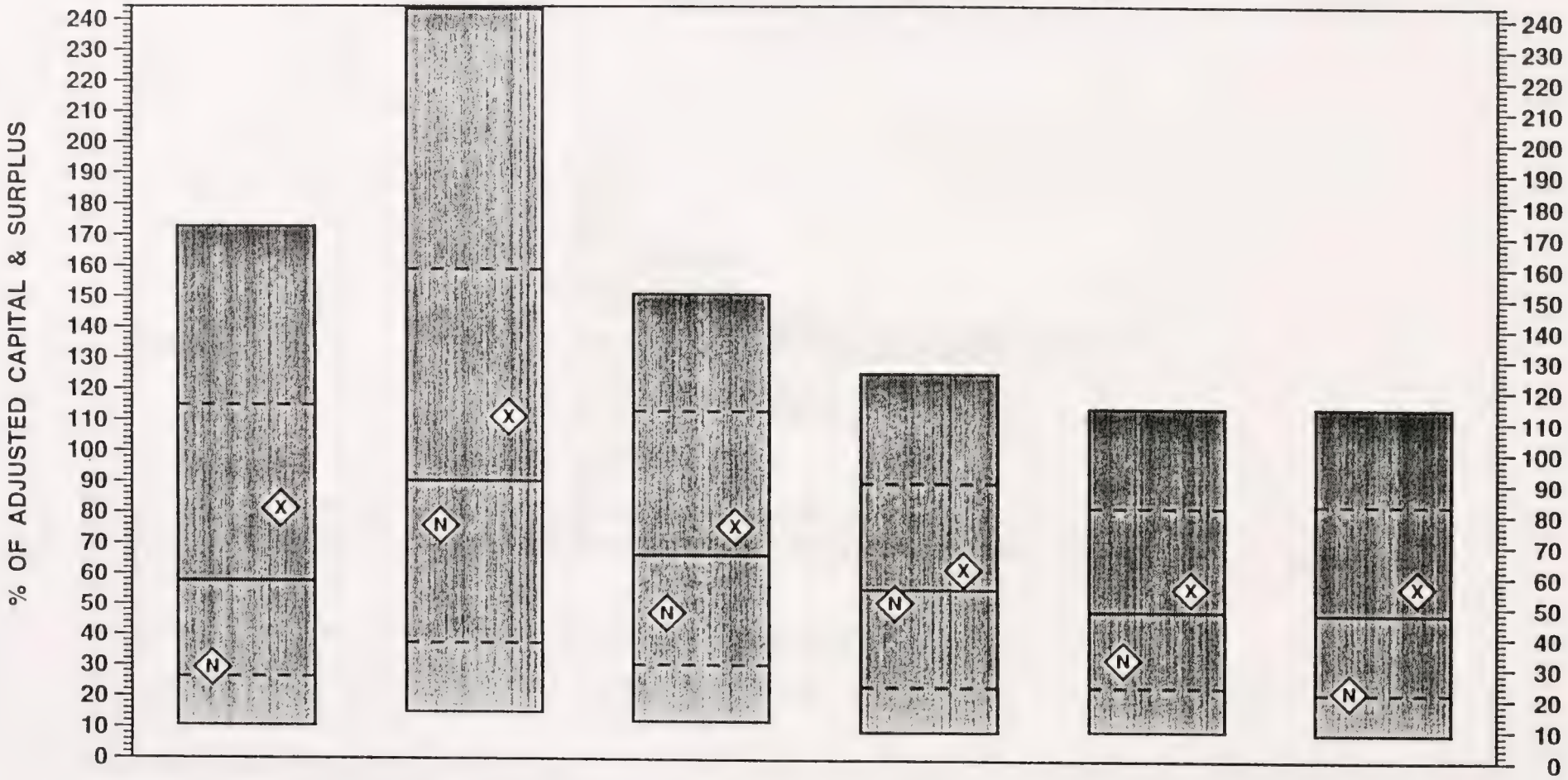
High Risk Assets as a Percentage of Invested Assets

Nationwide's exposure to non-investment grade bonds, non-performing mortgages (mortgages in foreclosure plus mortgages 90 days past due), real estate acquired in default, and high risk assets overall is below the median of MICI's peer group for each respective category.

High Risk Assets as a Percentage of Adjusted Capital and Surplus

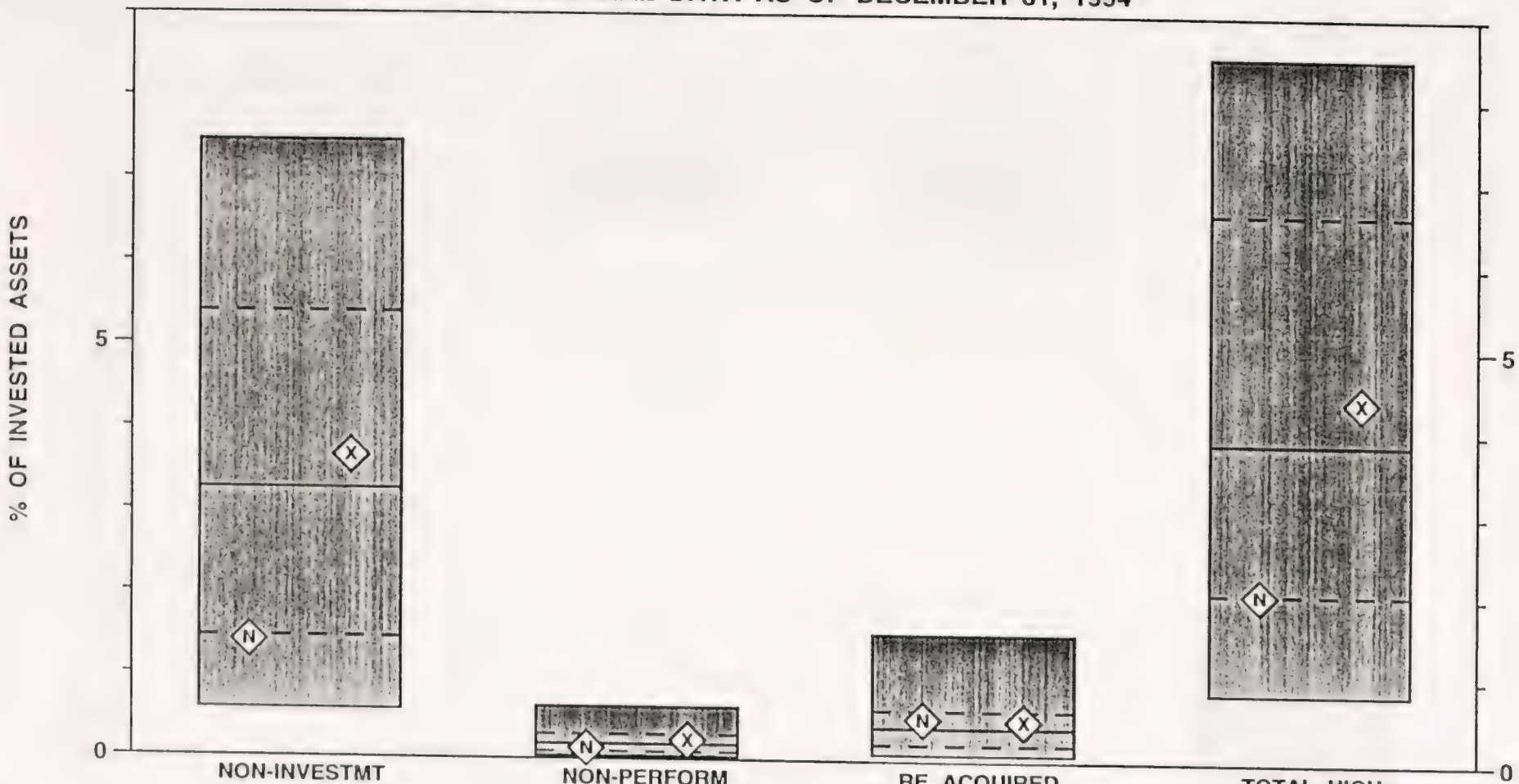
Nationwide's exposure to non-investment grade bonds, non-performing mortgages, real estate acquired in default, and total high risk assets is relatively better as a percentage of adjusted capital and surplus.

PEER GROUP COMPARISONS
HIGH RISK ASSETS AS A PERCENTAGE OF ADJUSTED CAPITAL & SURPLUS
FOR THE SIX MOST RECENT CALENDAR YEARS



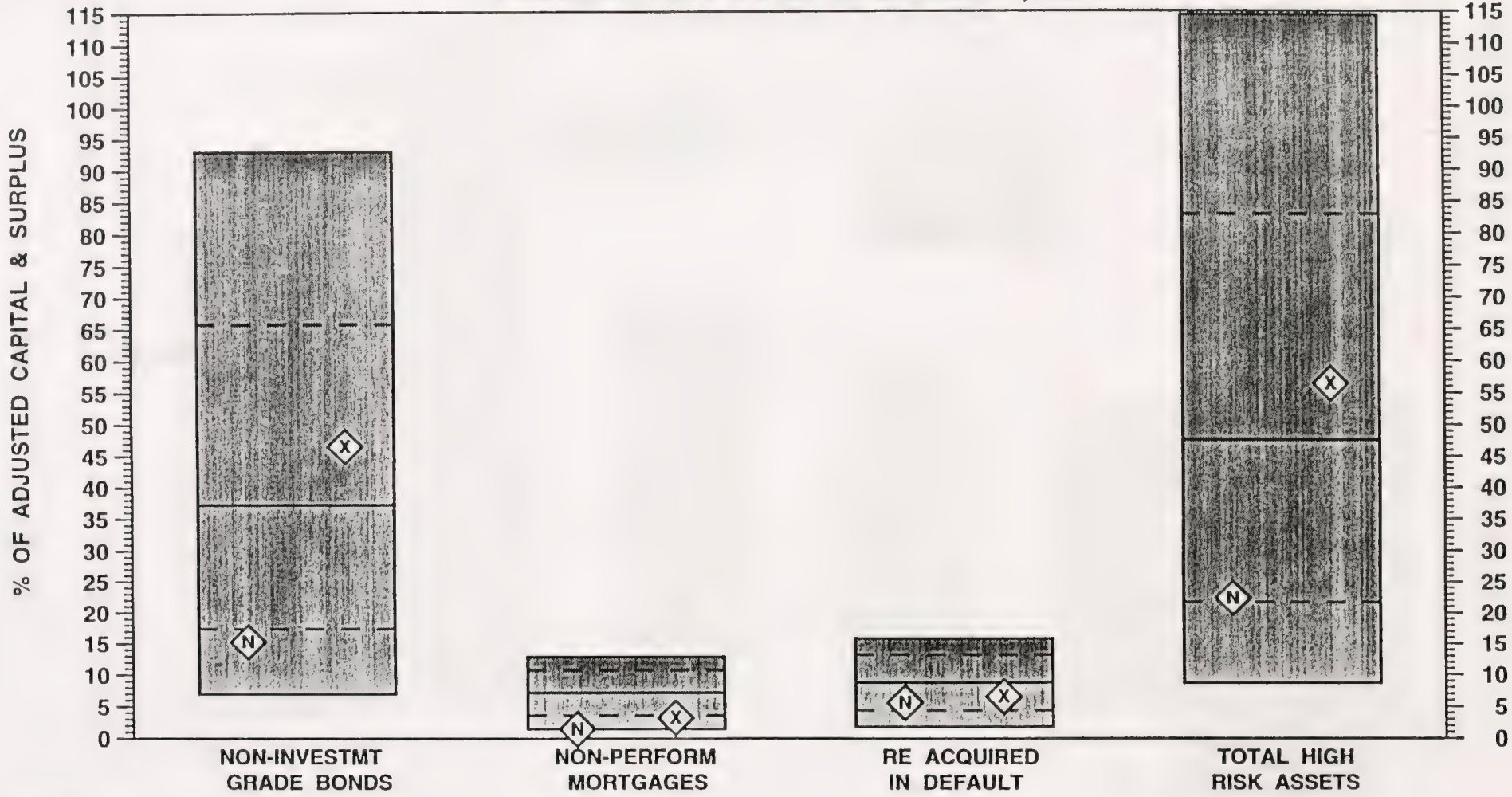
	1989	1990	1991	1992	1993	1994
10th Percentile	172.74	243.07	151.17	125.41	114.32	114.44
25th Percentile	114.90	159.05	113.25	89.92	81.99	82.93
MEDIAN	57.63	90.34	66.56	55.46	48.32	47.59
75th Percentile	26.33	37.52	30.54	23.51	23.53	21.67
90th Percentile	10.53	15.01	12.23	9.03	9.41	8.67
NATIONWIDE N	29.22	75.83	47.54	51.05	32.63	22.35
GROUP MEAN X	81.16	111.14	75.75	62.06	55.88	56.40

PEER GROUP COMPARISONS
HIGH RISK ASSETS AS A PERCENTAGE OF INVESTED ASSETS
FINANCIAL DATA AS OF DECEMBER 31, 1994



	NON-INVESTMT GRADE BONDS	NON-PERFORM MORTGAGES	RE ACQUIRED IN DEFAULT	TOTAL HIGH RISK ASSETS
10th Percentile	7.45	0.63	1.53	8.52
25th Percentile	5.39	0.30	0.61	6.62
MEDIAN	3.26	0.18	0.40	3.87
75th Percentile	1.45	0.09	0.20	2.05
90th Percentile	0.58	0.04	0.08	0.83
NATIONWIDE N	1.40	0.13	0.51	2.04
GROUP MEAN X	3.66	0.23	0.49	4.38

PEER GROUP COMPARISONS
HIGH RISK ASSETS AS A PERCENTAGE OF ADJUSTED CAPITAL & SURPLUS
FINANCIAL DATA AS OF DECEMBER 31, 1994



	NON-INVESTMT GRADE BONDS	NON-PERFORM MORTGAGES	RE ACQUIRED IN DEFAULT	TOTAL HIGH RISK ASSETS
10th Percentile	93.03	12.86	15.82	114.44
25th Percentile	65.87	10.72	13.19	82.93
MEDIAN	37.27	7.15	8.79	47.59
75th Percentile	17.44	3.57	4.40	21.67
90th Percentile	6.98	1.43	1.76	8.67
NATIONWIDE N	15.31	1.43	5.61	22.35
GROUP MEAN X	46.57	3.22	6.60	56.40

CREDIT DATA DISCLOSURE

Mercer Investment Consulting, Inc. (MICI) advises benefit plan trustees and others in the investment of funds entrusted to them. While it is our business to collect, summarize and explain information which is useful in such decisions, and to assist in completing the transaction once a client has made an investment decision, we cannot guarantee or make representations regarding the solvency of particular financial institutions. Published financial ratings cited in our reports are supplied by independent ratings agencies, based in part on information not available to Mercer. All information is gathered from sources considered reliable, but Mercer cannot guarantee its accuracy, and such information may be incomplete or condensed. We encourage you to place your business with companies that have received high ratings and are in good financial standing. High ratings and financial strength are not guarantees of future solvency, but they can be key indicators of an institution's future ability to meet its obligations.

AGGRESSIVE GROWTH

AIM Constellation Fund (Institutional Class)
Janus Twenty Fund
Mass Investors Growth Fund
Putnam Voyager Fund
Twentieth Century Growth Investors
Twentieth Centurty Ultra Investors

Three funds in the aggressive growth category standout as top performers; the Twentieth Century Investors Ultra Fund, the AIM Constellation Fund, and the Putnam Voyager Fund. Each of these funds outperformed both the Russell 2000 and the Aggressive Growth Fund Median for the one-, three-, five-, and ten-year periods ending December 31, 1995. All three funds returned in excess of 17% annualized for the three year period and 22% annualize for the five year period compared to 14.5% and 21.0%, for the Russell 2000 index for the same time period. These three funds contain approximately $2.5 million of Plan assets.

The performance of the three other aggressive funds has been mixed. The Massachusetts Investors Growth Stock Fund trailed the aggressive fund category median for each time period observed, and underperformed the Russell 2000 for the one, three and five year periods. The Janus Twenty Fund underperformed both the Russell 2000 and the aggressive median for the three and five year periods. The Fund had a higher ten-year return, however, than the Russell 2000 and the aggressive median. The Twentieth Century Investors Growth Fund trailed the Russell 2000 and category median for the one, three, and five year periods, matched the median and beat the Russell 2000 for the ten-year period. Despite Twentieth Century Investors Growth's near-term underperformance, the fund still had a large participant balance ($2.7 million).

GROWTH FUNDS

AIM Weingarten Fund (Institutional Class)
Dreyfus Third Century Fund
Fidelity Contrafund
Fidelity Magellan
The Growth Fund of America
Janus Fund
MFS Growth Opportunitites Fund
Nationwide Growth Fund
Neuberger & Berman Manhattan Fund
Davis New York Venture Fund
Putnam Investors Fund
Seligman Growth Fund
Twentieth Century Select Investors

The top performers in the growth category include the Fidelity Contrafund, the Fidelity Magellan Fund, the Davis New York Venture Fund, and the Putnam Investors Fund. Each of these funds outperformed the Growth Fund Category Median for the time periods observed. The Magellan Fund and the Davis New York Venture Fund have also outperformed the S&P 500 for each of the time periods observed. The Fidelity Contrafund outperformed the S&P 500 for all time periods except the one-year period. The Putnam Investors Fund outperformed the S & P 500 for all time periods except the ten-year period. Each of these funds performed well on a risk-adjusted basis for the two time periods evaluated (three and five year periods). The combined assets in these four funds is approximately $4.5 million with the majority of these assets split between the Putnam Investors Fund and the Fidelity Magellan Fund.

The Growth Stock Fund of America, the Janus Fund, and the Neuberger & Berman Manhattan Fund all outperformed the growth fund category median for the five and ten year periods, but have underperformed the S&P 500 for each of the time periods observed. These three funds also failed to perform above the median in the three year period. The Janus Fund scored well on a risk/return basis, but underperformed the median for the one- and three-year periods. The combined assets in all three funds is just over $600 thousand.

The Nationwide Fund, the AIM Weingarten Fund, and the MFS Growth Opportunities Fund had very inconsistent performance. Each of these funds have outperformed the median for at least one time period, but none has outperformed the S&P 500 for the time periods observed. The MFS Growth Opportunities Fund has demonstrated the highest risk of the growth funds for both the three- and five-year periods. The fund has a relatively high balance of $1.7 million.

The bottom performers within the growth category include the Dreyfus Third Century Fund, the Seligman Growth Fund, and the Twentith Century Select Investors Fund. The Dreyfus Third Century recently experienced a change in its investment manager and a substantial improvement in performance in 1995. It is also generally characterized as a socially responsible

fund. All three funds have underperformed both the S&P 500 and the growth fund median for each of the time periods observed. The total assets in these three funds is $300 thousand.

GROWTH & INCOME FUNDS

Evergreen Total Return Fund
Fidelity Asset Manager
Fidelity Equity - Income Fund
Fidelity Growth & Income Portfolio
The Income Fund of America
Invesco Industrial Income Fund
Natonwide Fund

The Fidelity Equity Income Fund and the Fidelity Growth & Income Fund are the top performers in the Growth & Income Category. Both funds outperformed the Growth & Income Fund Category Median for the time periods observed.

The Nationwide Fund underperformed the median for the one, three and five year periods, but still had an above median ten-year performance. The Evergreen Total Return Fund underperformed the median for each of the time periods observed.

Of these four funds, the Fidelity Equity Income Fund had the most Plan assets ($2.6 million), followed by the Nationwide Fund with $621 thousand.

The Invesco Industrial Income Fund, the Income Fund of America, and the Fidelity Asset Manager Fund all are listed in the growth & income section, but are actually balanced funds. Of these three funds, the Invesco Industrial Income Fund had the best overall rates of return, but the Income Fund of America had the better risk-adjusted performance (by providing solid returns with a lower standard deviation). The Fidelity Asset Manager Fund had the poorest absolute overall performance and the poorest risk-adjusted performance of the funds in this classification. The combined assets in these three funds is just over $432 thousand with the majority split between the Income Fund of America and the Fidelity Asset Manager Fund.

INTERNATIONAL FUNDS

T. Rowe Price International Stock Fund
Templeton Foreign Fund
Templeton Smaller Company Growth

It is difficult to qualify any of the international funds as the "best" performer in the category. Each of these funds have demonstrated good performance over specific time periods. The Templeton Smaller Company Growth Fund had the best five-year performance on both an absolute basis and a risk-adjusted basis. However, the fund slipped in the three and ten year periods by having the lowest return offered in the international fund category for those two time periods. The T. Rowe Price International Stock Fund and the Templeton Foreign Fund had more consistent performance and stayed above the international median for each of the time periods observed. The T. Rowe Price International Stock Fund has demonstrated slightly higher risk, but has outperformed Templeton in the one and three year periods. The Templeton Fund had the better five and ten year performance and slightly less risk. The total assets in the international funds is $1.18 million ($585 thousand in the T. Rowe Price International, $492 thousand in the Templeton Foreign, and $99 thousand in the Templeton Smaller Company Fund).

INCOME FUNDS

The Bond Fund of America
Fidelity Capital & Income Fund
MFS High Income Fund
Nationwide Bond Fund

As a group the Income Funds performed very well. Each of the four current options, except the Nationwide Bond Fund, outperformed the Corporate Bond Fund Median during the one, three, five and ten year periods ending December 31, 1995, for the four time periods observed (Nationwide failed in the ten-year period). It is important to distinguish the Bond Fund of America and the Nationwide Bond Fund, which are general corporate bond funds from the Fidelity Capital & Income Fund and the MFS High Income Fund which are high yield (or junk bond) funds. High yield bond funds are normally more risky, but represent greater potential for higher returns.

The two high yield funds have very similar overall risk-adjusted performance, while the Bond Fund of America has clearly outperformed the Nationwide Bond Fund on a risk-adjusted basis within the general bond category.

Of the $614 thousand invested in the bond funds, over half is in the MFS High Income Fund and a third in the Bond Fund of America.

GOVERNMENT BOND FUNDS

Federated GNMA Trust
Federated U.S. Government 2-5 Years

Both the Federated GNMA Fund ($934 balance) and the Federated U.S. Government 2-5 years Fund ($177 balance) have fared well on a risk-adjusted basis and have been near or above the Government/Agency Median for the time periods observed. The total balances in these two funds is only $1,111. This probably reflects the competition from the Nationwide Fixed Annuity.

State of Montana Deferred Compensation Plan
Rates of Return[1] for the Periods Ending December 31, 1995

	4th Quarter 1995	One Year	Annualized		
			Three Years	Five Years	Ten Years
Aggressive Growth Funds					
AIM Constellation Fund (Institutional Class)	(4.1%)	36.2%	17.7%	25.8%[2]	20.4%[2]
Janus Twenty Fund	0.6%	36.2%	9.5%	17.8%	15.1%
Mass Investors Growth Fund	0.1%	28.3%	11.1%	16.6%	13.2%
Putnam Voyager Fund	6.9%	40.2%	18.6%	22.4%	18.3%
Twentieth Century Growth Investors	(8.4%)	20.4%	7.2%	14.8%	14.2%
Twentieth Century Ultra Investors	(1.1%)	37.7%	17.4%	25.0%	19.8%
Russell 2000	2.2%	28.4%	14.5%	21.0%	11.3%
Cadence Aggressive Growth Fund Median	1.5%	32.1%	13.8%	20.2%	14.2%
Growth Funds					
AIM Weingarten Fund (Institutional Class)	(1.5%)	35.4%	11.4%	14.6%	15.8%[3]
Dreyfus Third Century Fund	3.5%	35.8%	9.8%	13.2%	11.6%
Fidelity Contrafund	1.6%	36.3%	17.8%	24.1%	19.4%
Fidelity Magellan	(1.5%)	36.8%	18.8%	20.4%	17.4%
The Growth Fund of America	(0.1%)	29.8%	14.1%	16.7%	14.9%
Janus Fund	3.0%	29.4%	12.4%	16.7%	15.6%
MFS Growth Opportunities Fund	2.9%	34.5%	14.4%	14.6%	11.3%
Nationwide Growth Fund	2.1%	28.7%	13.3%	16.0%	12.8%
Neuberger & Berman Manhattan Fund	(4.2%)	31.0%	11.6%	16.5%	13.4%
New York Venture Fund	1.9%	40.6%	17.0%	20.3%	17.0%
Putnam Investors Fund	4.8%	37.6%	16.0%	16.7%	13.8%
Seligman Growth Fund	4.0%	28.5%	9.5%	15.1%	12.7%
Twentieth Century Select Investors	0.4%	22.7%	9.0%	10.2%	11.8%
S&P 500	6.0%	37.5%	15.3%	16.5%	14.8%
Cadence Growth Fund Median	3.5%	30.6%	12.7%	16.0%	12.9%

[1] Fund returns shown net of investment advisors fees.

[2] Returns are for the retail class. Plan investment is in the institutional class shares, which is the same fund, but with lower expenses.

[3] Returns are for the retail class of shares. The institutional class of shres were incepted in 1992.

N/A = Not applicable.

Source: Thomson Investment Software, Inc. (formerly CDA Investment Technologies, Inc.)

State of Montana Deferred Compensation Plan
Rates of Return[1] for the Periods Ending December 31, 1995

	4th Quarter 1995	One Year	Annualized		
			Three Years	Five Years	Ten Years
Growth and Income Funds					
Evergreen Total Return Fund	3.3%	23.9%	9.4%	12.1%	9.5%
Fidelity Asset Manager	3.7%	18.2%	10.8%	13.7%	N/A
Fidelity Equity - Income Fund	5.8%	31.8%	17.0%	18.9%	13.1%
Fidelity Growth & Income Portfolio	7.6%	35.4%	18.3%	21.2%	19.1%
The Income Fund of America	5.9%	29.1%	12.8%	14.8%	12.2%
Invesco Industrial Income Fund	5.1%	27.3%	12.6%	16.1%	14.6%
Nationwide Fund	7.1%	30.0%	11.8%	13.4%	13.4%
S&P 500	6.0%	37.5%	15.3%	16.5%	14.8%
Cadence Growth & Income Median	4.8%	30.4%	13.1%	15.0%	12.3%
Income Funds					
The Bond Fund of America	4.2%	18.3%	8.6%	11.6%	9.8%
Fidelity Capital & Income Fund	(0.3%)	16.7%	11.6%	18.3%	11.3%
MFS High Income Fund	2.0%	17.2%	10.9%	18.9%	9.3%
Nationwide Bond Fund	6.2%	24.2%	8.1%	9.8%	8.9%
Lehman Brothers Aggregate	4.3%	18.5%	8.1%	9.5%	9.6%
Lehman Brothers Corporate	4.9%	22.3%	9.6%	11.2%	10.5%
Cadence Corporate Bond Median	3.9%	16.5%	7.2%	8.8%	9.1%
Index Funds					
SEI Index Funds (S&P 500 Index)	5.9%	37.4%	15.1%	16.3%	14.4%
S&P 500	6.0%	37.5%	15.3%	16.5%	14.8%
Cadence Growth & Income Median	4.8%	30.4%	13.1%	15.0%	12.3%
International Funds					
T. Rowe Price Int'l Stock Fund	2.7%	11.4%	15.7%	11.6%	14.9%
Templeton Foreign Fund	0.2%	11.2%	15.1%	12.6%	16.2%
Templeton Smaller Co. Growth	(1.6%)	17.6%	14.0%	16.5%	11.2%
MSCI EAFE Index	4.1%	11.6%	17.0%	9.7%	14.0%
Cadence Int'l Equity Median	1.4%	7.5%	14.3%	9.8%	13.0%

[1] Fund returns shown net of investment advisors fees.

N/A = Not applicable.

Source: Thomson Investment Software, Inc. (formerly CDA Investment Technologies, Inc.)

State of Montana Deferred Compensation Plan
Rates of Return[1] For The Periods Ending December 31, 1995

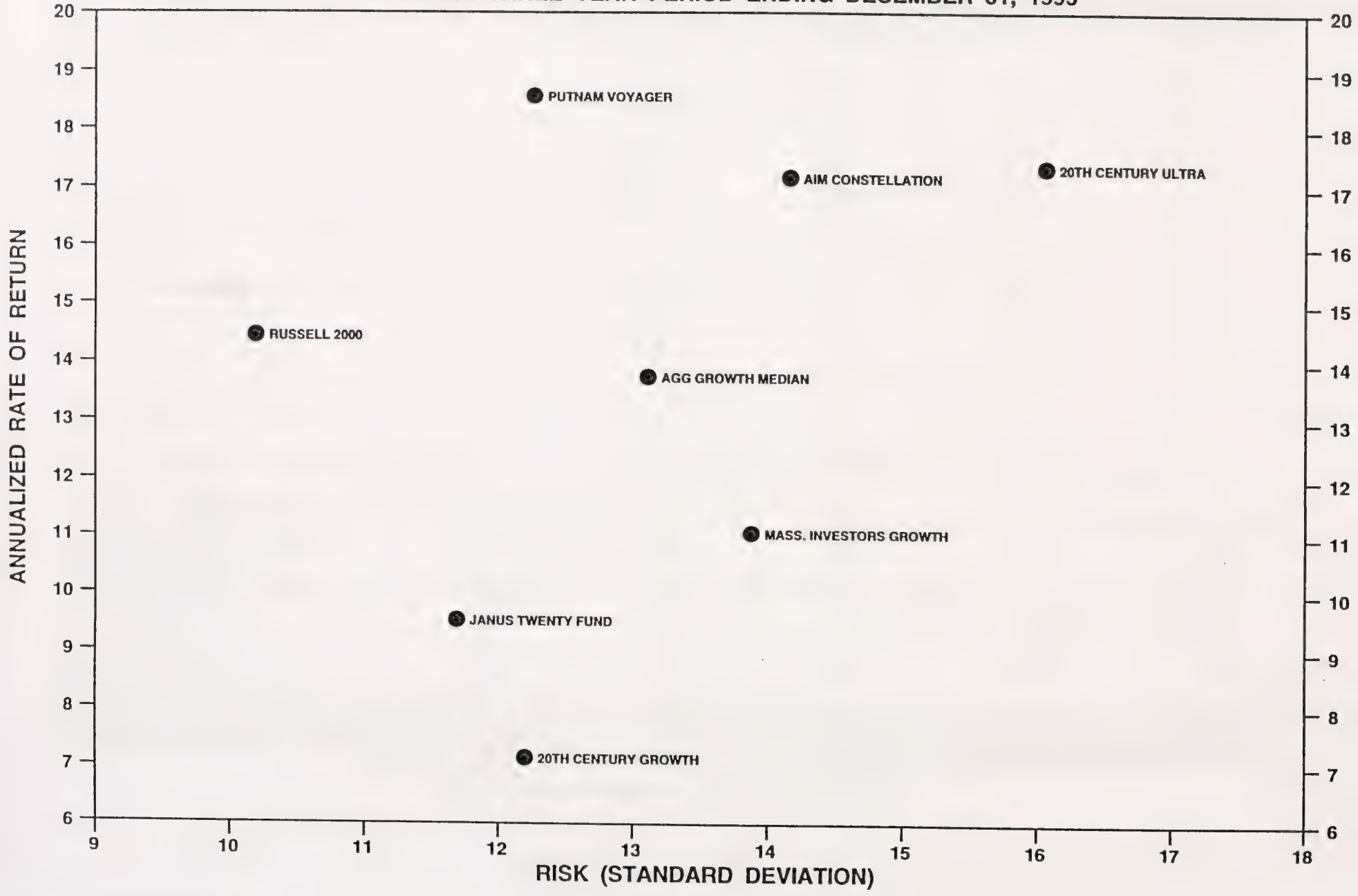
	4th Quarter 1995	One Year	Annualized		
			Three Years	Five Years	Ten Years
Government Bond Funds					
Federated GNMA Trust	2.9%	16.1%	6.4%	8.2%	8.9%
Federated U.S. Govt: 2-5 Years	3.2%	13.6%	6.1%	7.6%	8.0%
LB Aggregate	4.3%	18.5%	8.1%	9.5%	9.6%
ML 3-5 Year Government	3.7%	16.1%	7.2%	8.8%	9.0%
Cadence Govt/Agency Bond Median	3.3%	14.6%	6.0%	7.9%	8.3%
Money Market Funds					
Nationwide Money Market Fund	1.1%	4.5%	3.0%	3.1%	4.7%
Donoghue Money Market Index	1.3%	5.5%	4.0%	4.2%	5.7%

[1] Fund returns shown gross of investment advisors fees.

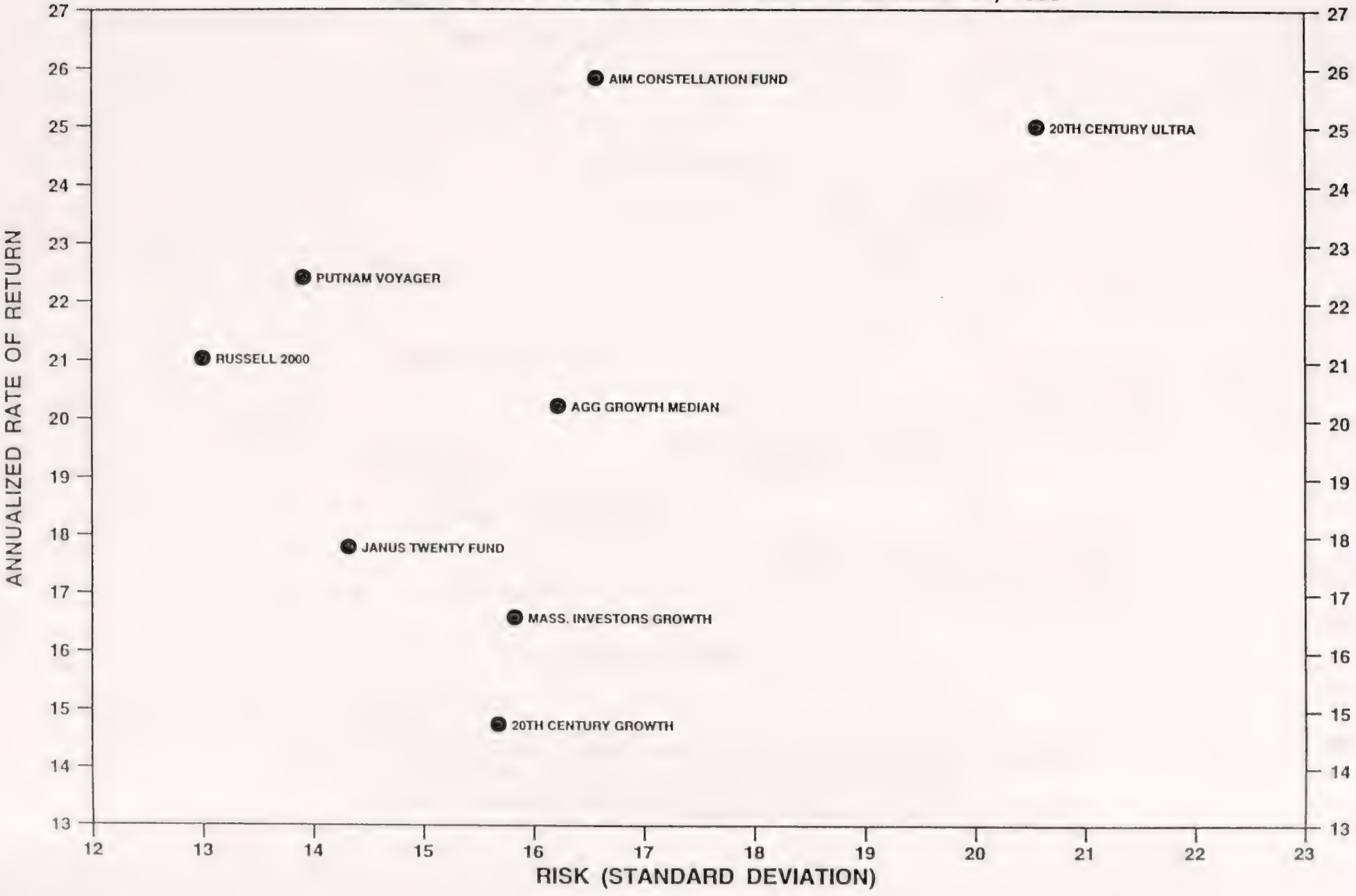
Source: Thomson Investment Software, Inc. (formerly CDA Investment Technologies, Inc.)

N/A = Not applicable.

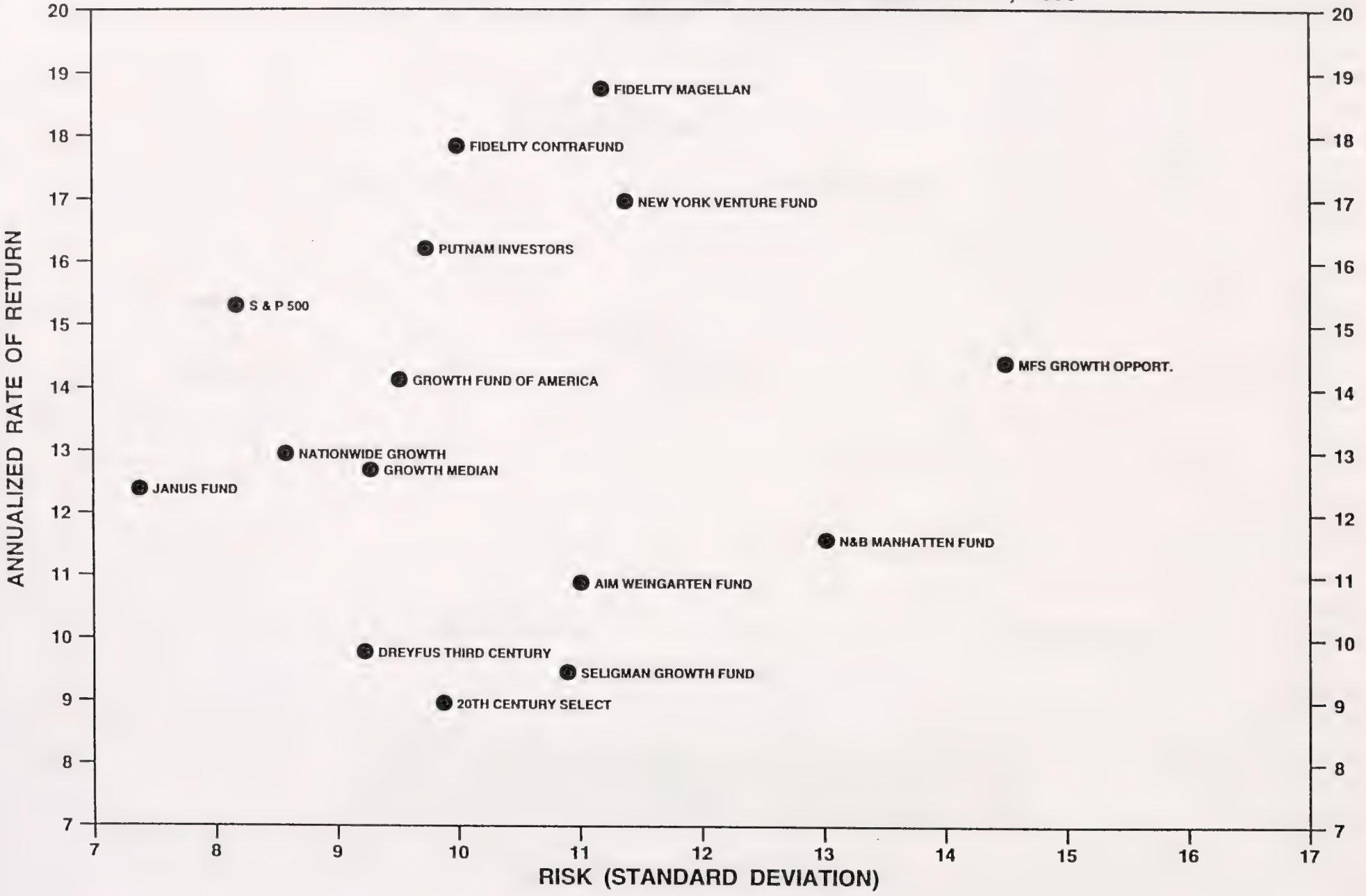
STATE OF MONTANA DEFERRED COMPENSATION PLAN
AGGRESSIVE EQUITY FUND RISK/RETURN ANALYSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



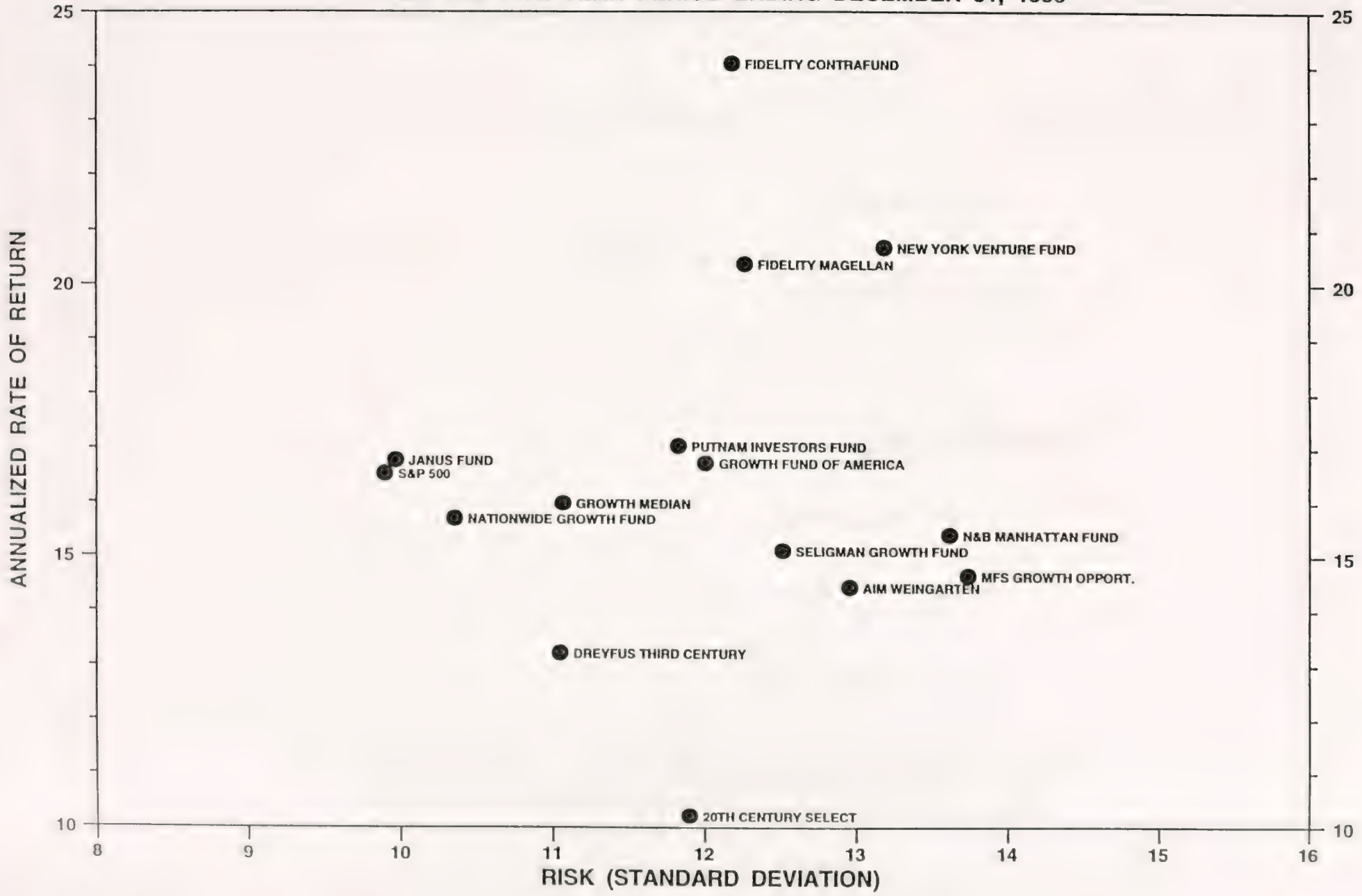
STATE OF MONTANA DEFERRED COMPENSATION PLAN
AGGRESSIVE EQUITY FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



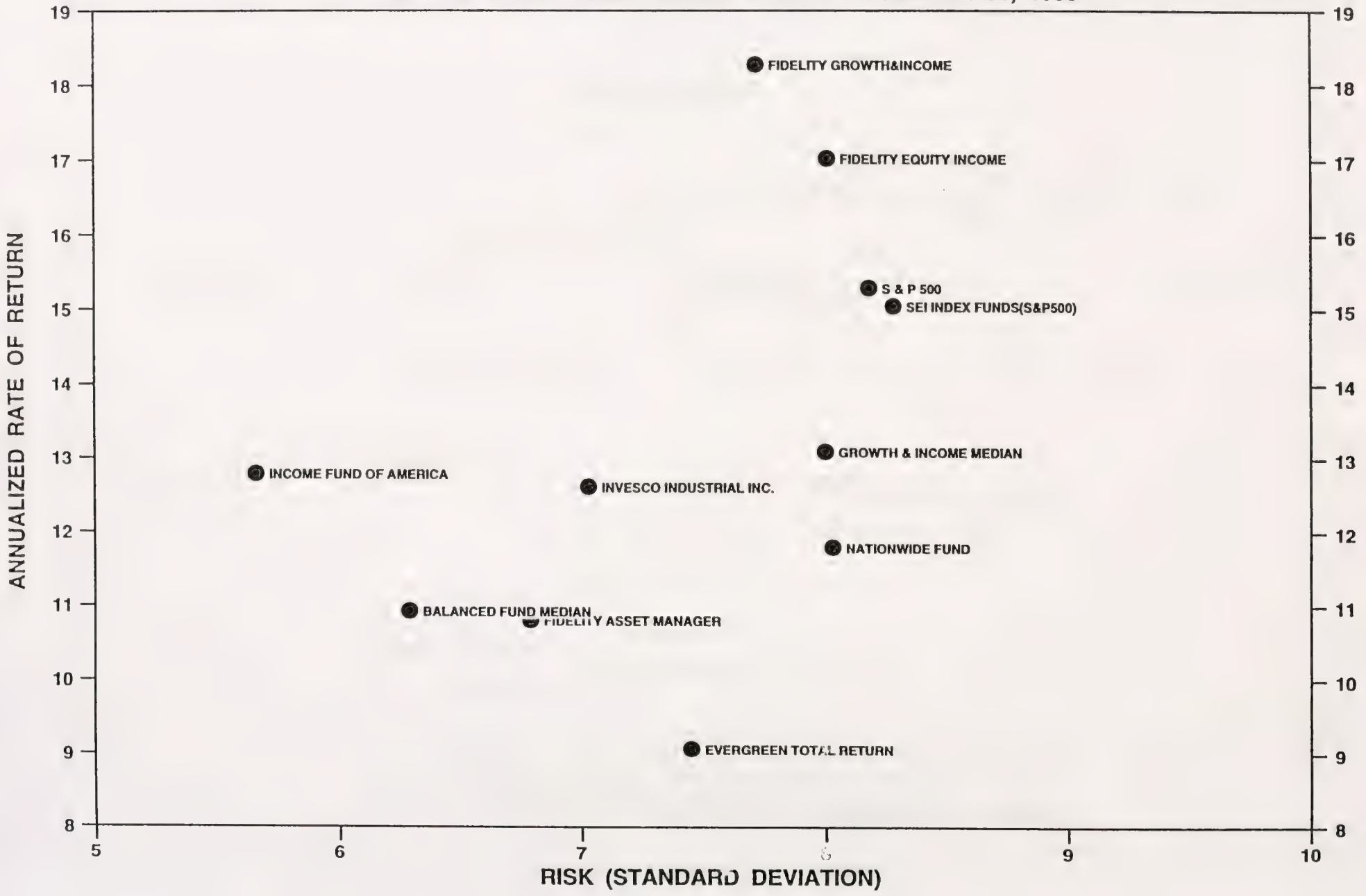
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUNDS RISK/RETURN ANALYSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



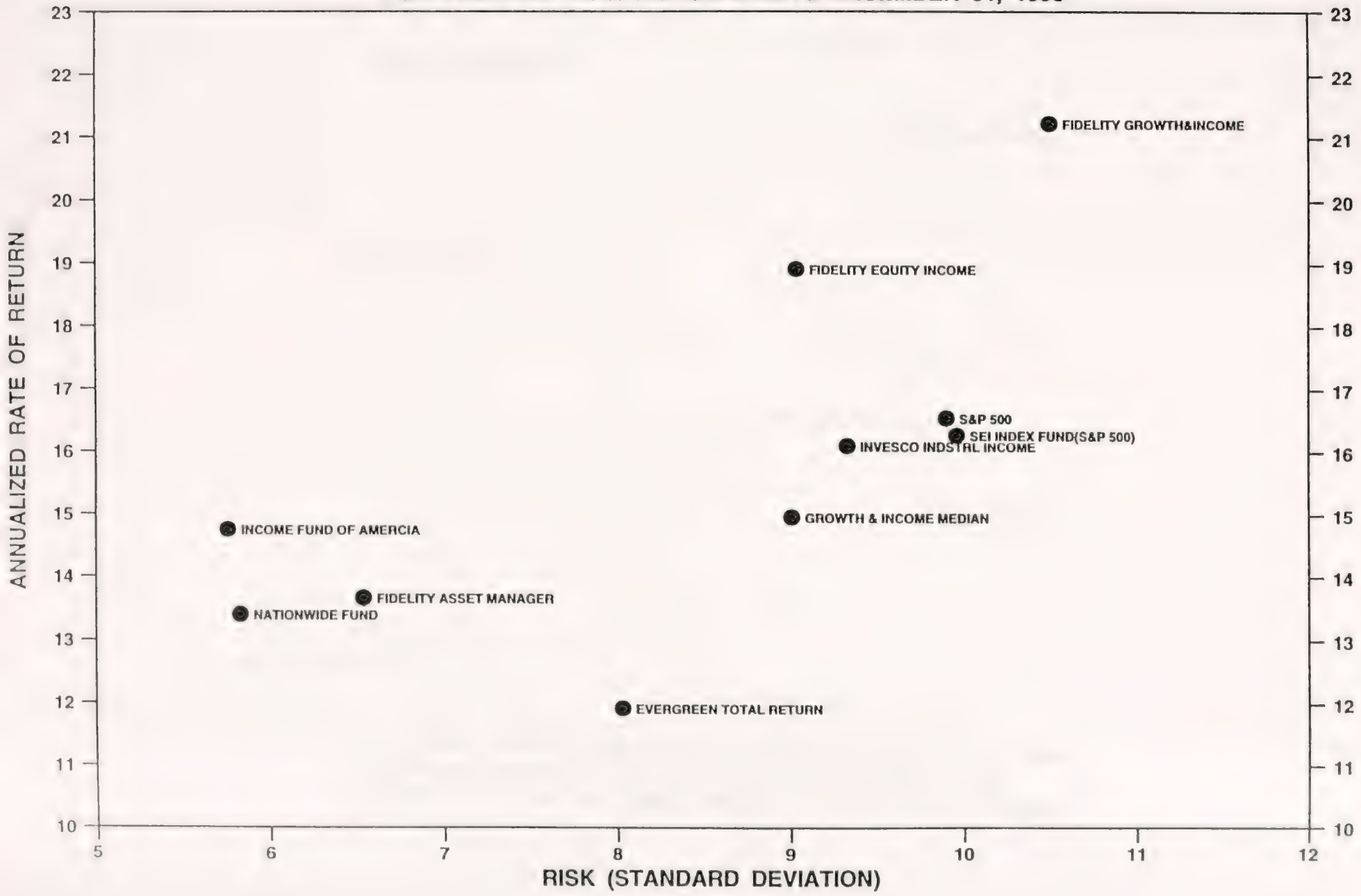
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



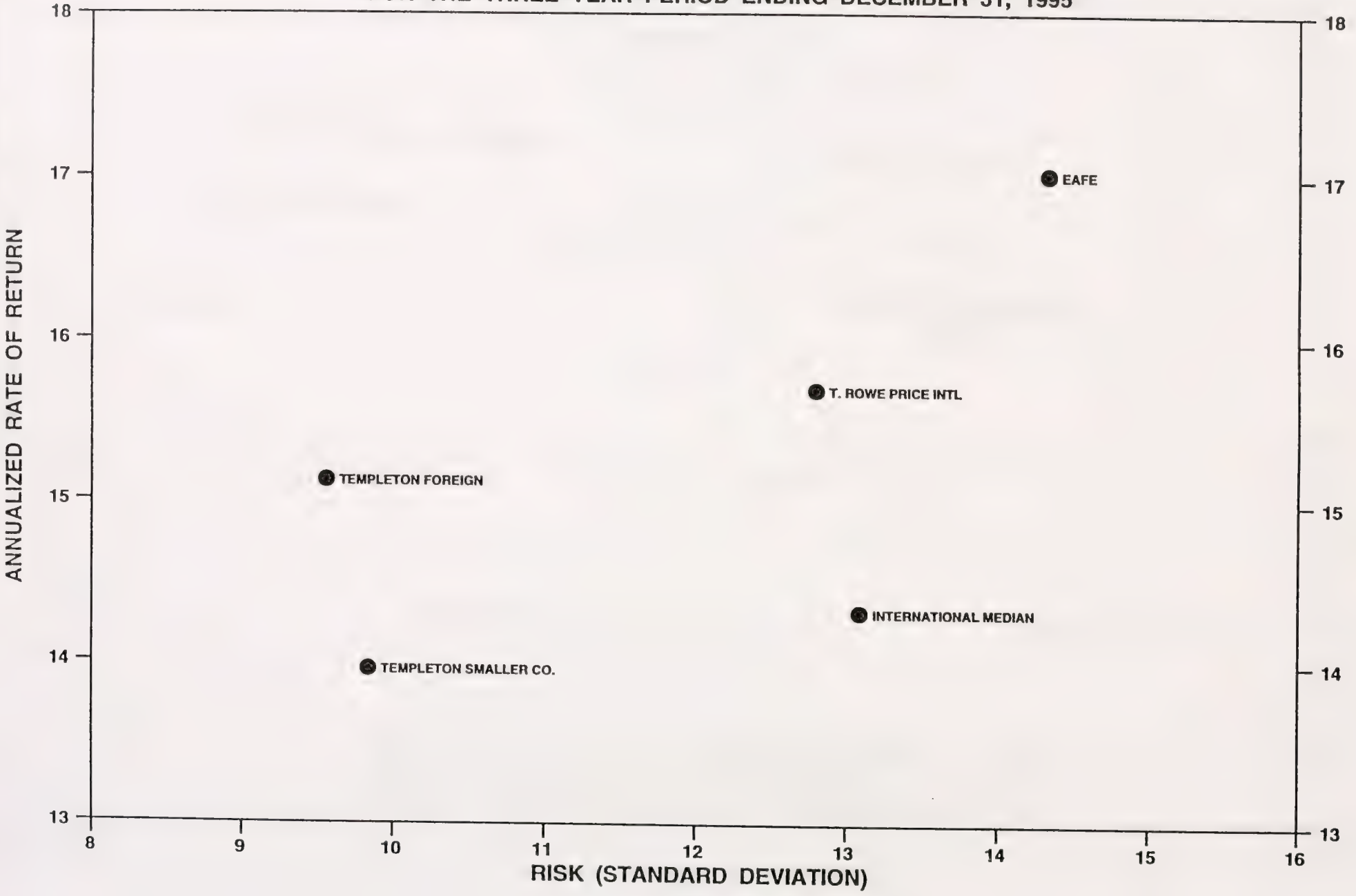
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH & INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



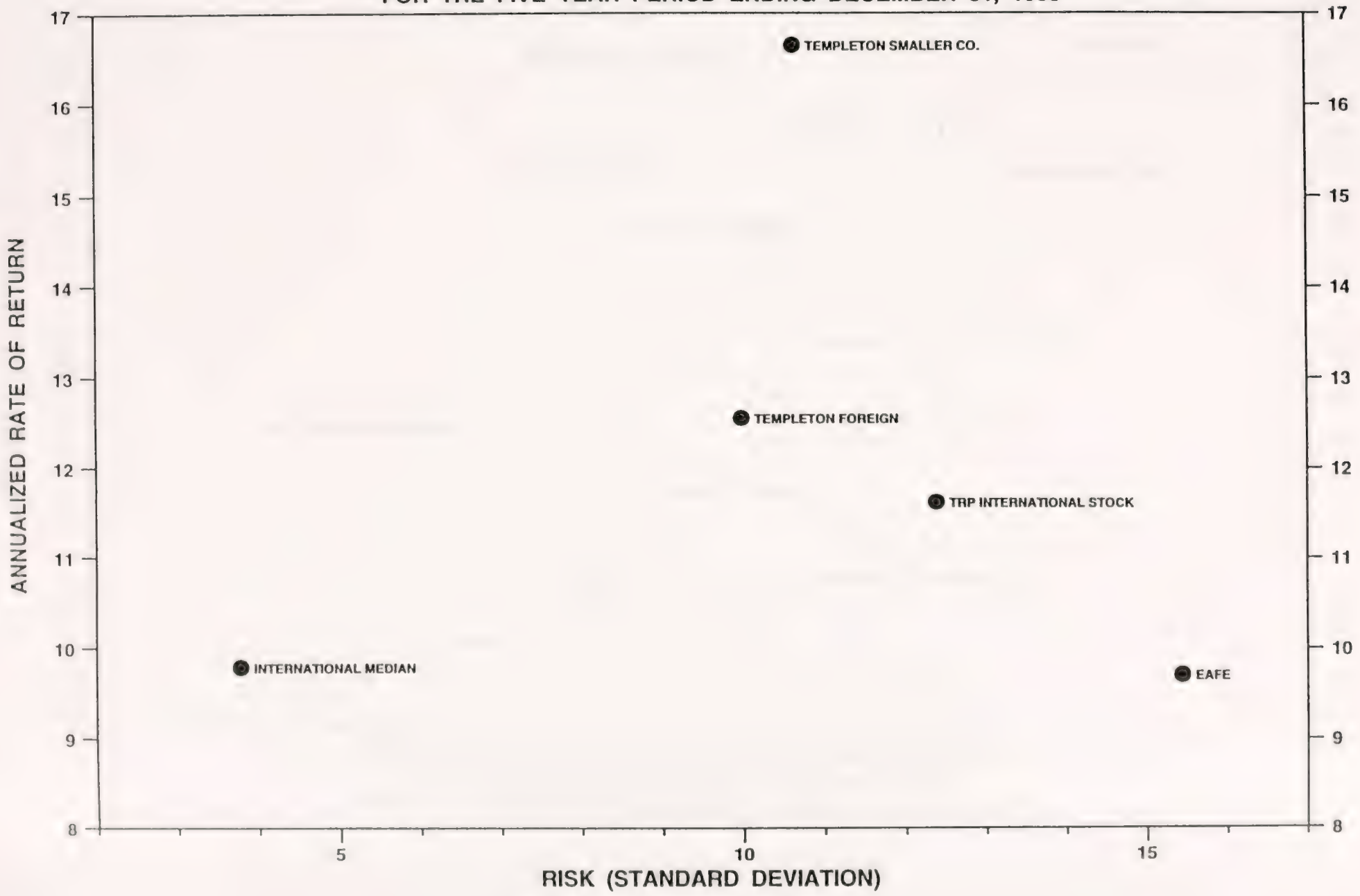
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH & INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



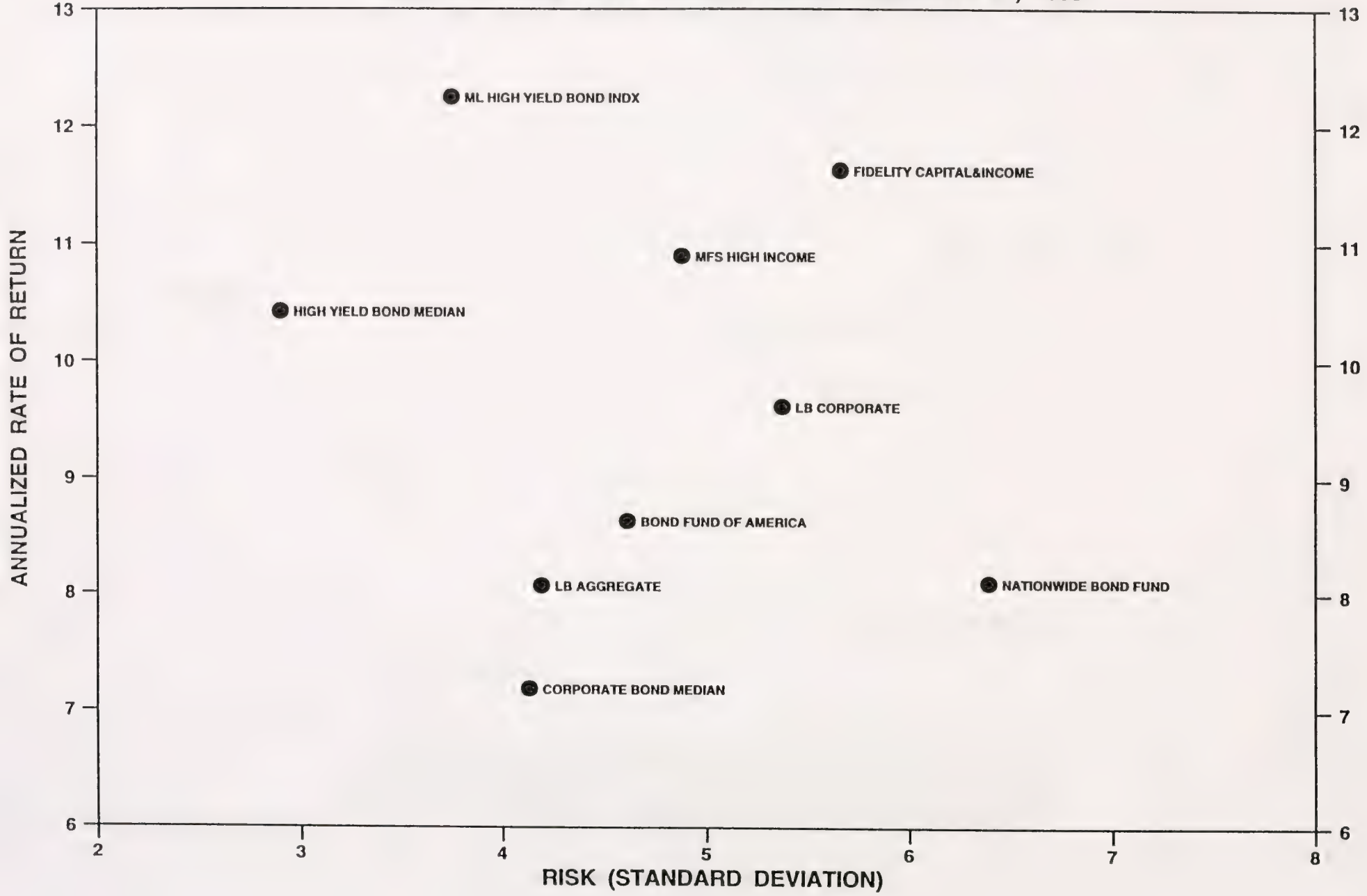
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INTERNATIONAL FUNDS RISK/RETURN ANAYLSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



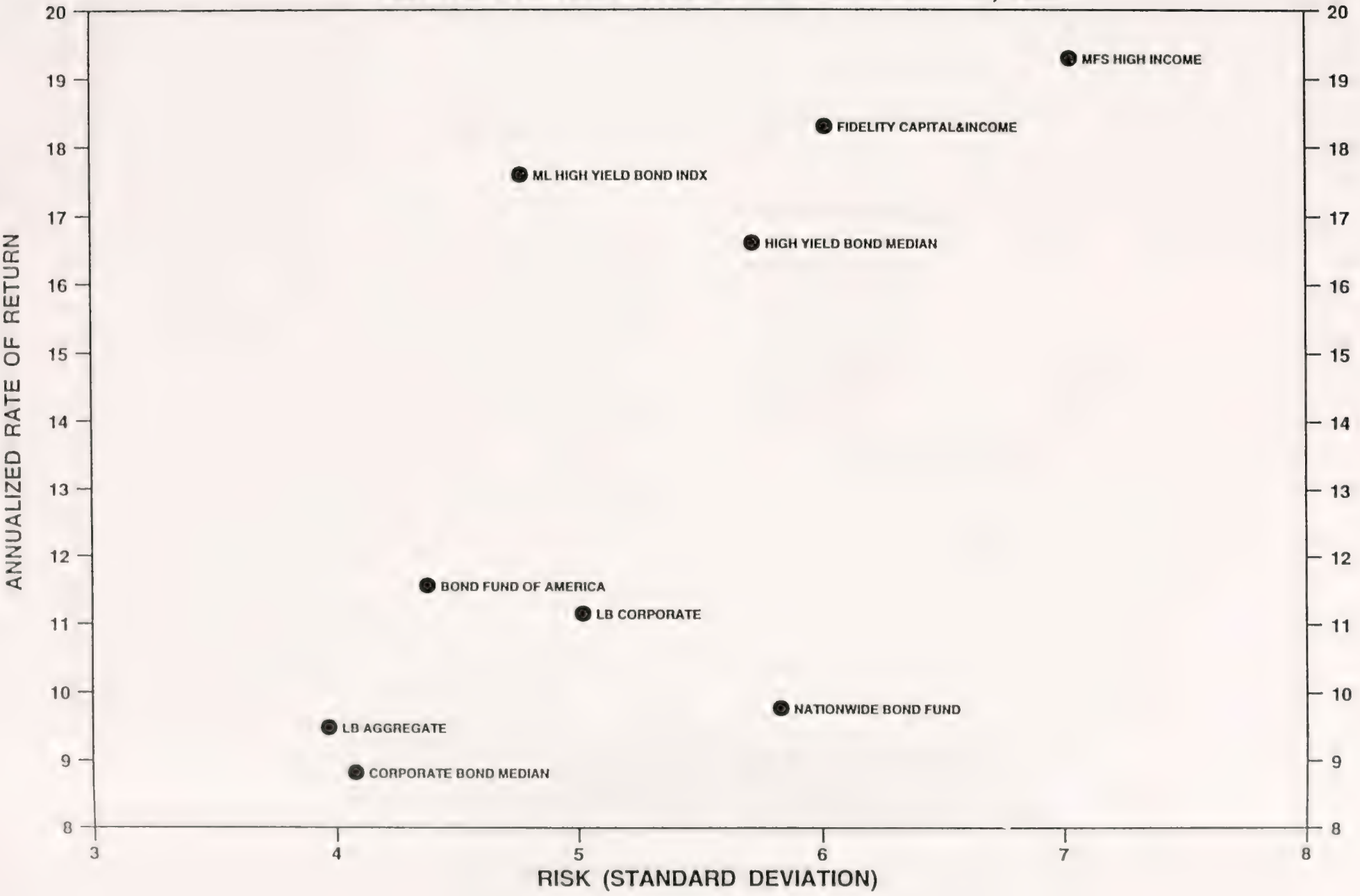
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INTERNATIONAL EQUITY FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



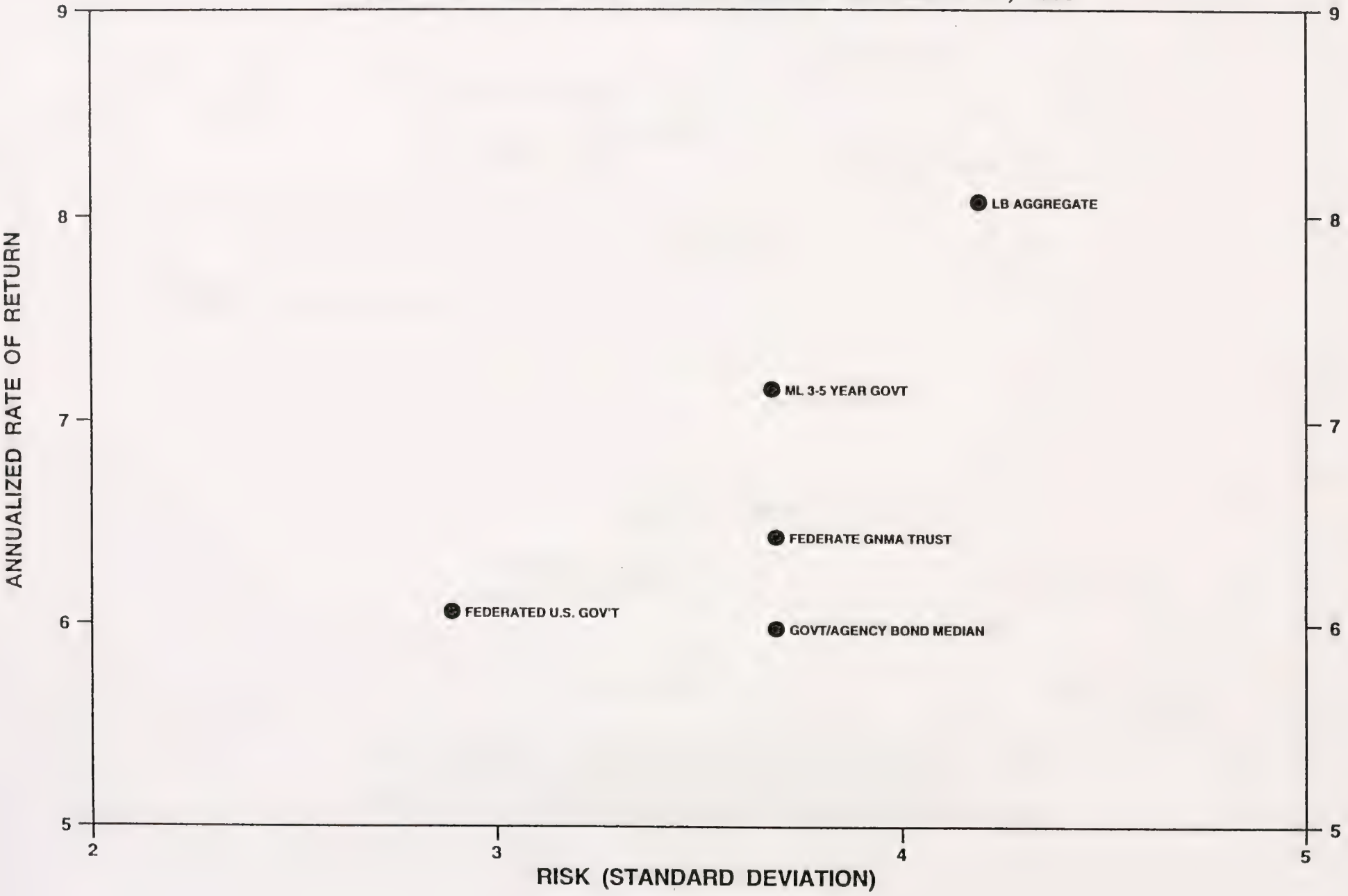
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



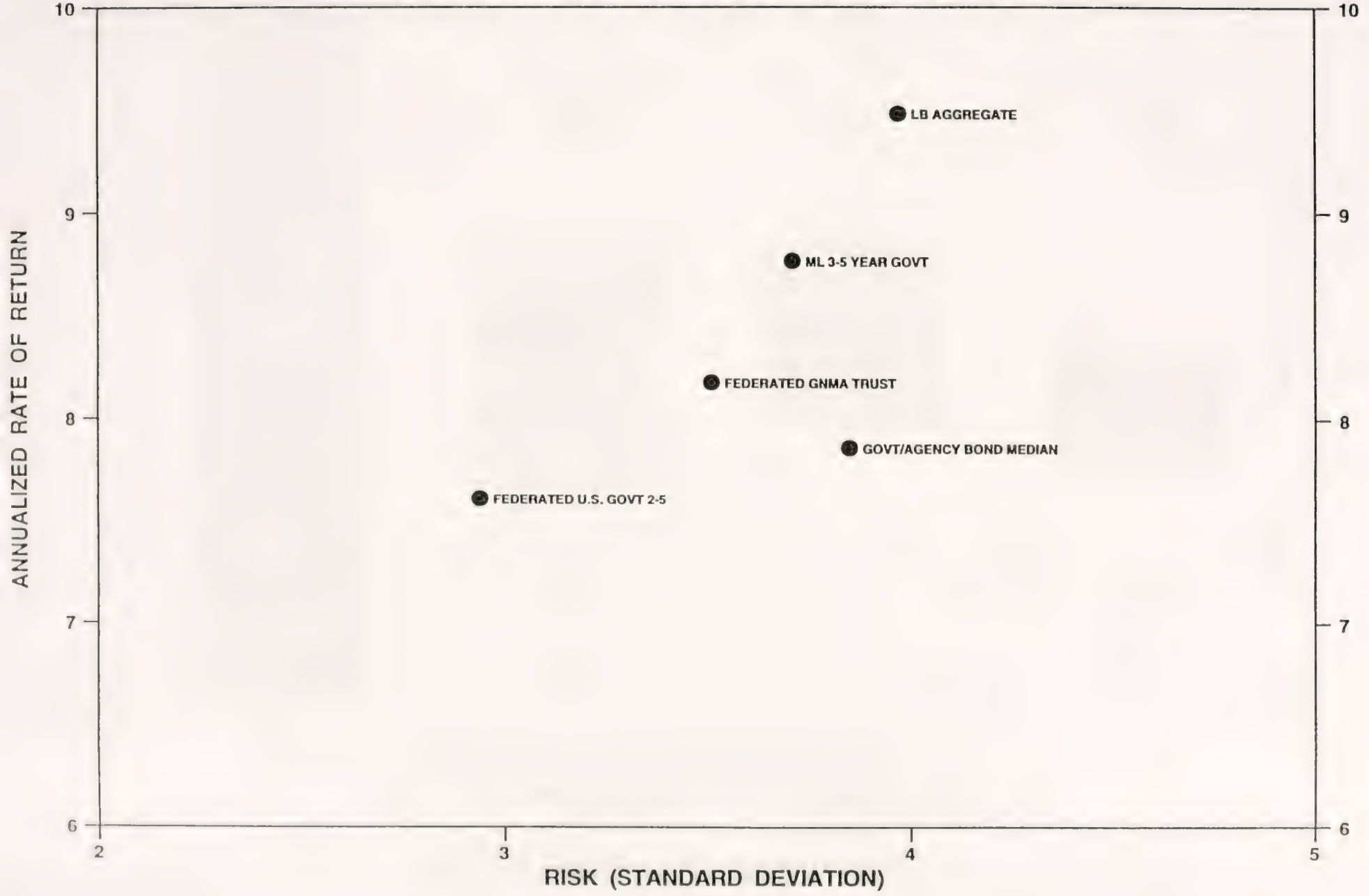
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



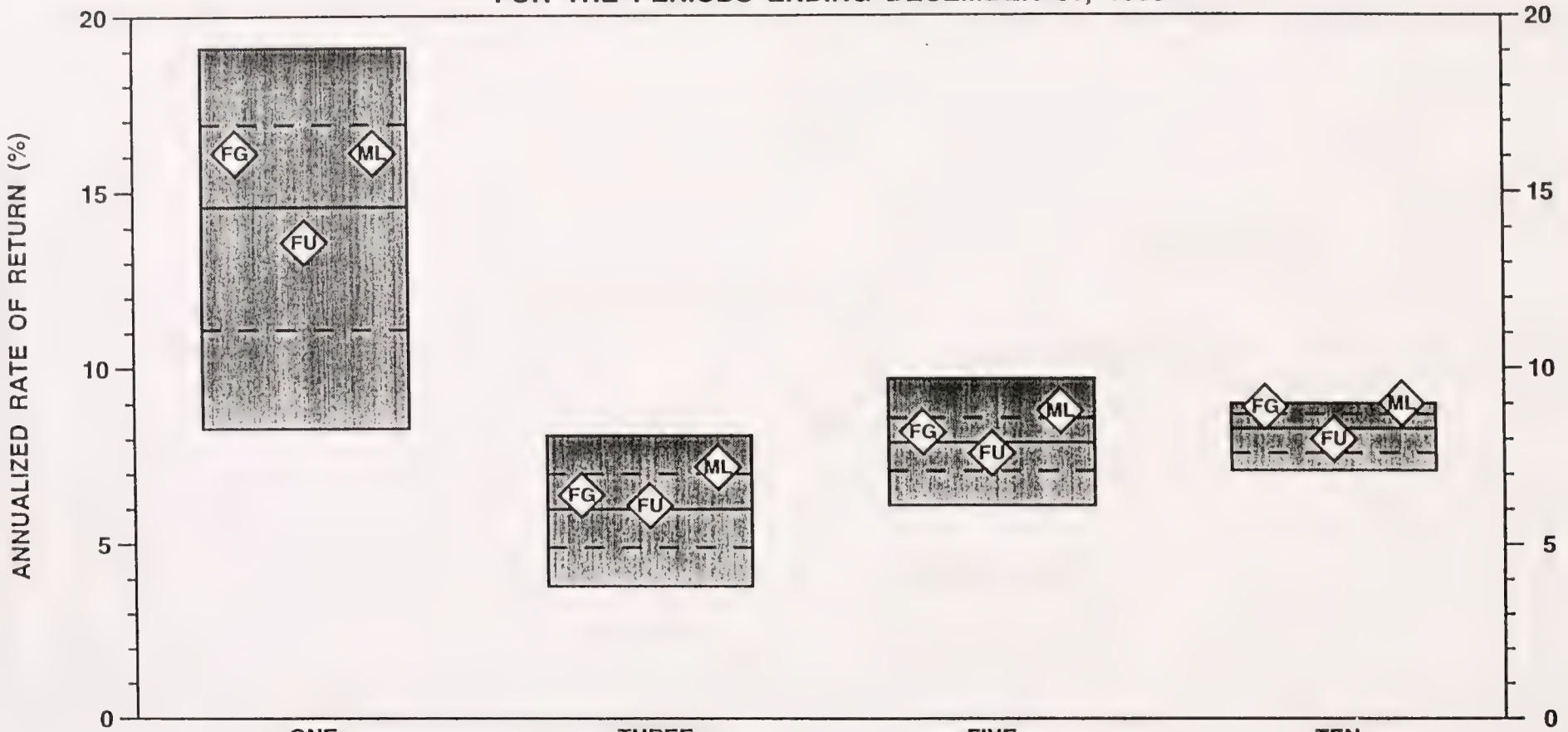
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GOVERNMENT BOND FUNDS RISK/RETURN ANALYSIS
FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 1995



STATE OF MONTANA DEFERRED COMPENSATION PLAN
GOVERNMENT BOND FUNDS RISK/RETURN ANALYSIS
FOR THE FIVE YEAR PERIOD ENDING DECEMBER 31, 1995



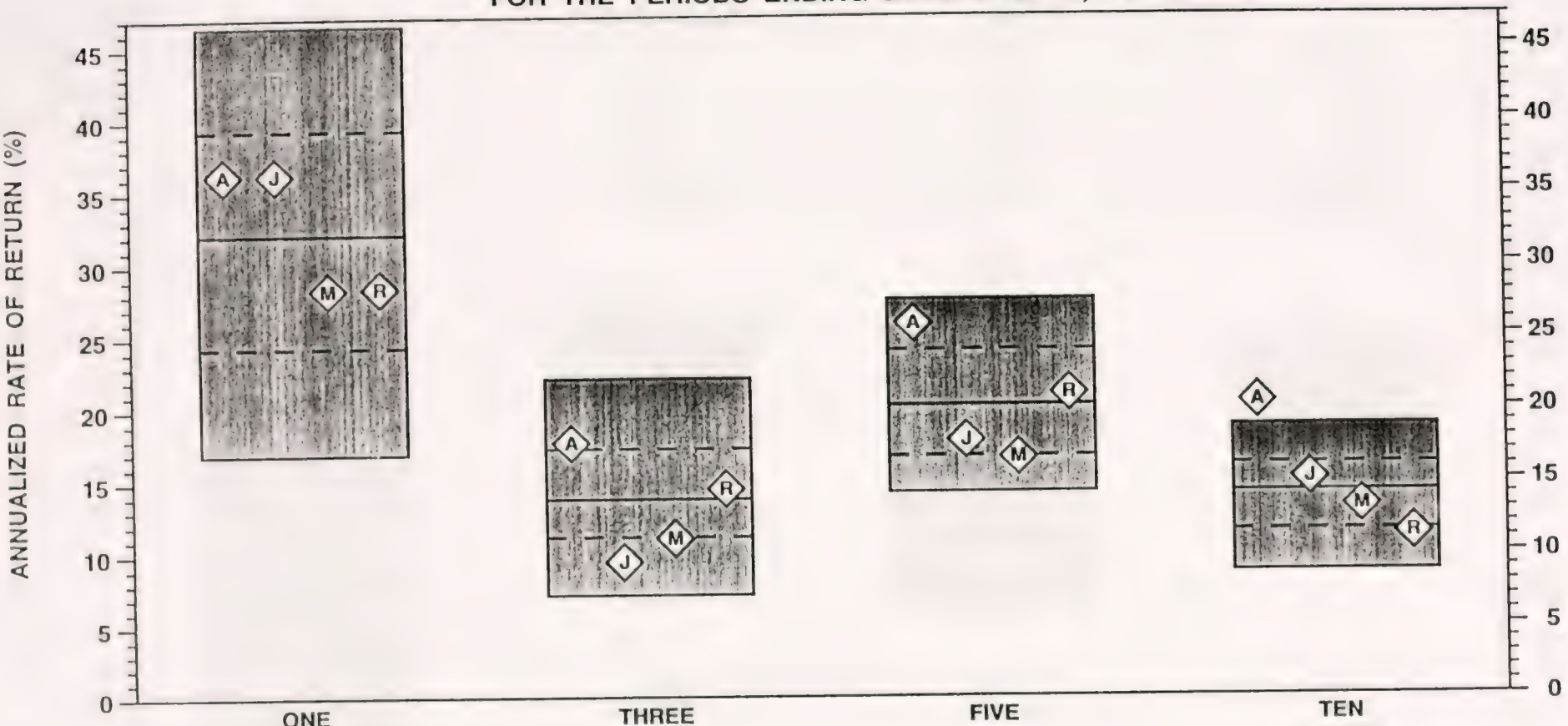
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GOVERNMENT BOND FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		19.1	8.1	9.7	9.0
25th Percentile		16.9	7.0	8.6	8.7
MEDIAN		14.6	6.0	7.9	8.3
75th Percentile		11.1	4.9	7.1	7.6
90th Percentile		8.3	3.8	6.1	7.1
FED-GNMA	FG	16.1	6.4	8.2	8.9
FED US-GOV	FU	13.6	6.1	7.6	8.0
ML 3-5YR	ML	16.1	7.2	8.8	9.0

CADENCE GOVT/AGENCY BOND UNIVERSE

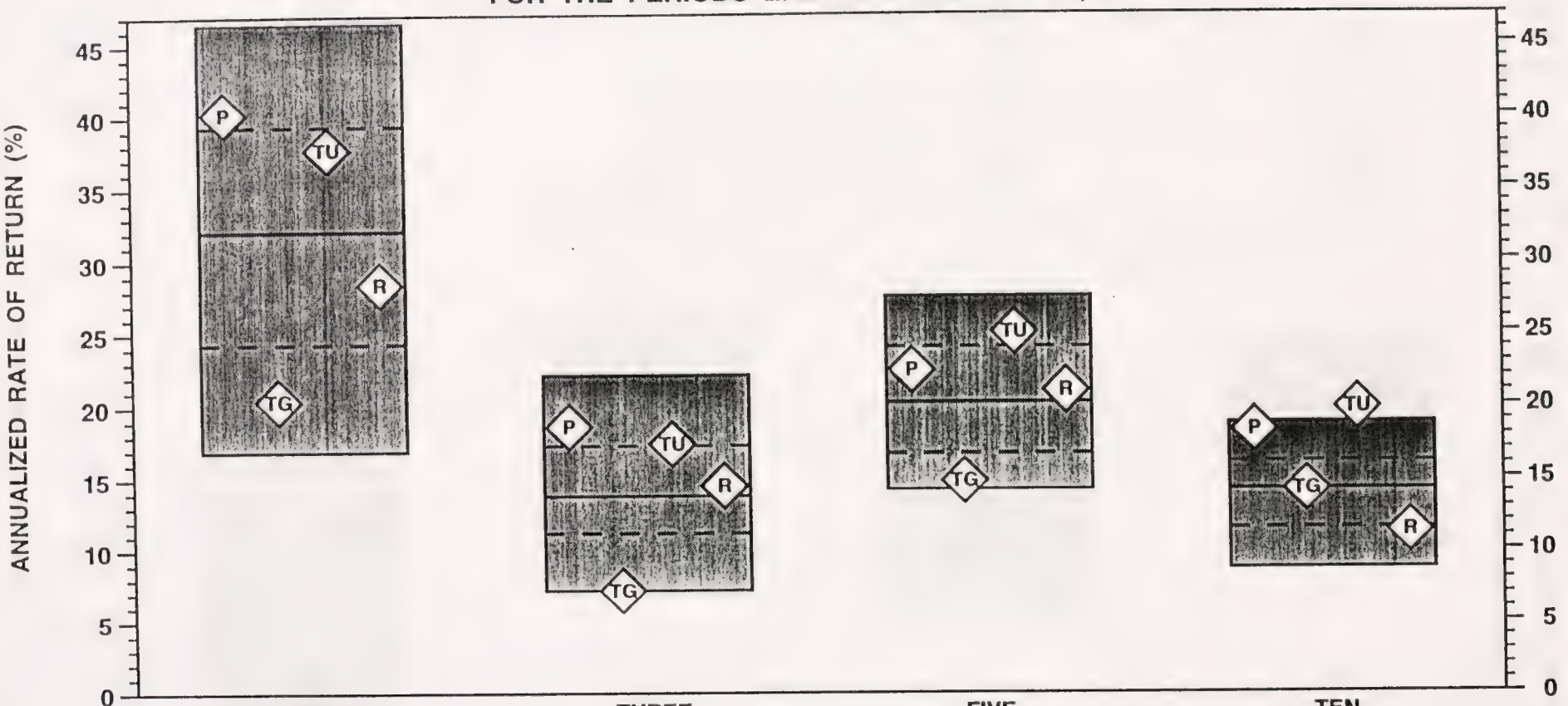
STATE OF MONTANA DEFERRED COMPENSATION PLAN
AGGRESSIVE EQUITY FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile	46.5	22.1	27.5	18.8
25th Percentile	39.3	17.3	24.0	16.1
MEDIAN	32.1	13.8	20.2	14.2
75th Percentile	24.3	11.2	16.7	11.5
90th Percentile	16.9	7.2	14.2	8.7
AIM A	36.2	17.7	25.8	20.4
JANUS J	36.2	9.5	17.8	15.1
MASS. M	28.3	11.1	16.6	13.2
RUSSELL R	28.4	14.5	21.0	11.3

CADENCE AGGRESSIVE GROWTH FUND UNIVERSE

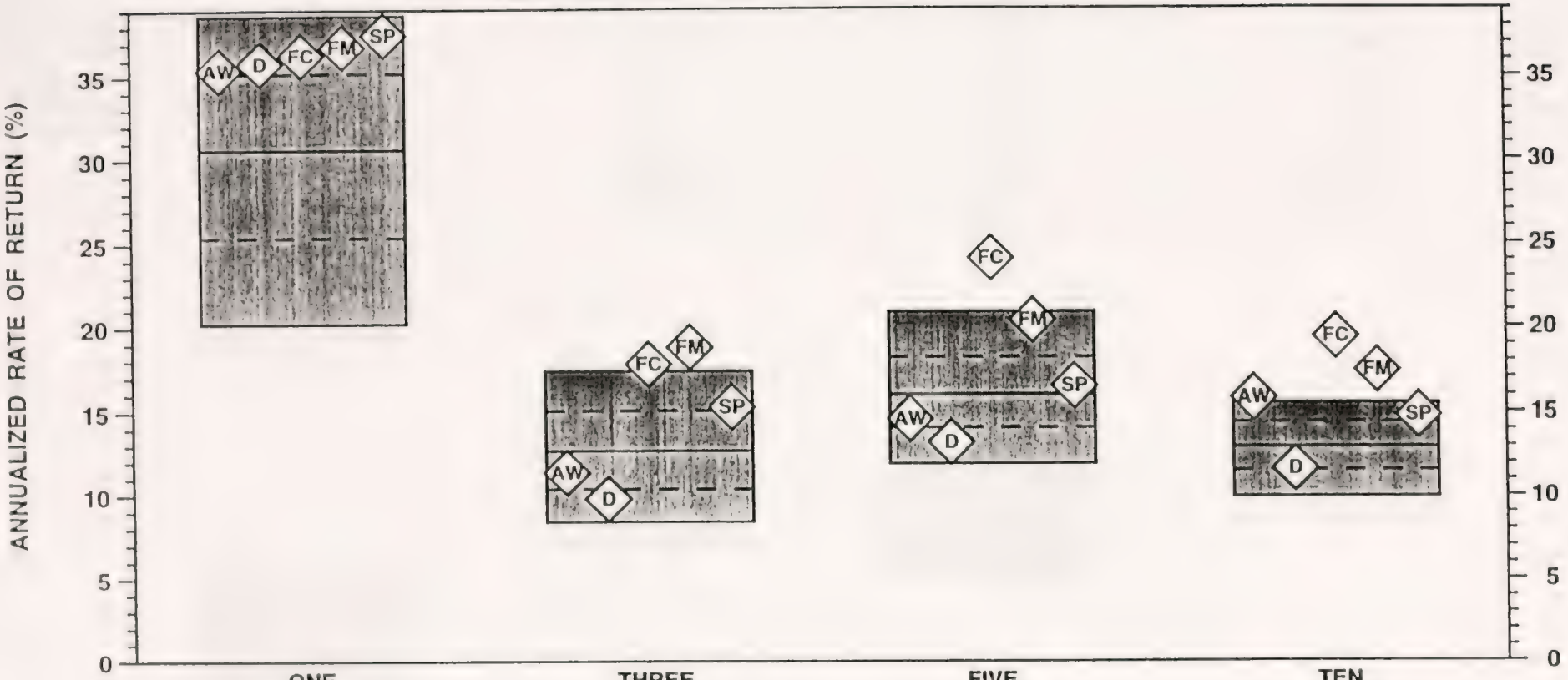
STATE OF MONTANA DEFERRED COMPENSATION PLAN
AGGRESSIVE EQUITY FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile	46.5	22.1	27.5	18.8
25th Percentile	39.3	17.3	24.0	16.1
MEDIAN	32.1	13.8	20.2	14.2
75th Percentile	24.3	11.2	16.7	11.5
90th Percentile	16.9	7.2	14.2	8.7
PUTNAM P	40.2	18.6	22.4	18.3
20TH C-GRW TG	20.4	7.2	14.8	14.2
20TH C-UTL TU	37.7	17.4	25.0	19.8
RUSSELL R	28.4	14.5	21.0	11.3

CADENCE AGGRESSIVE GROWTH FUND UNIVERSE

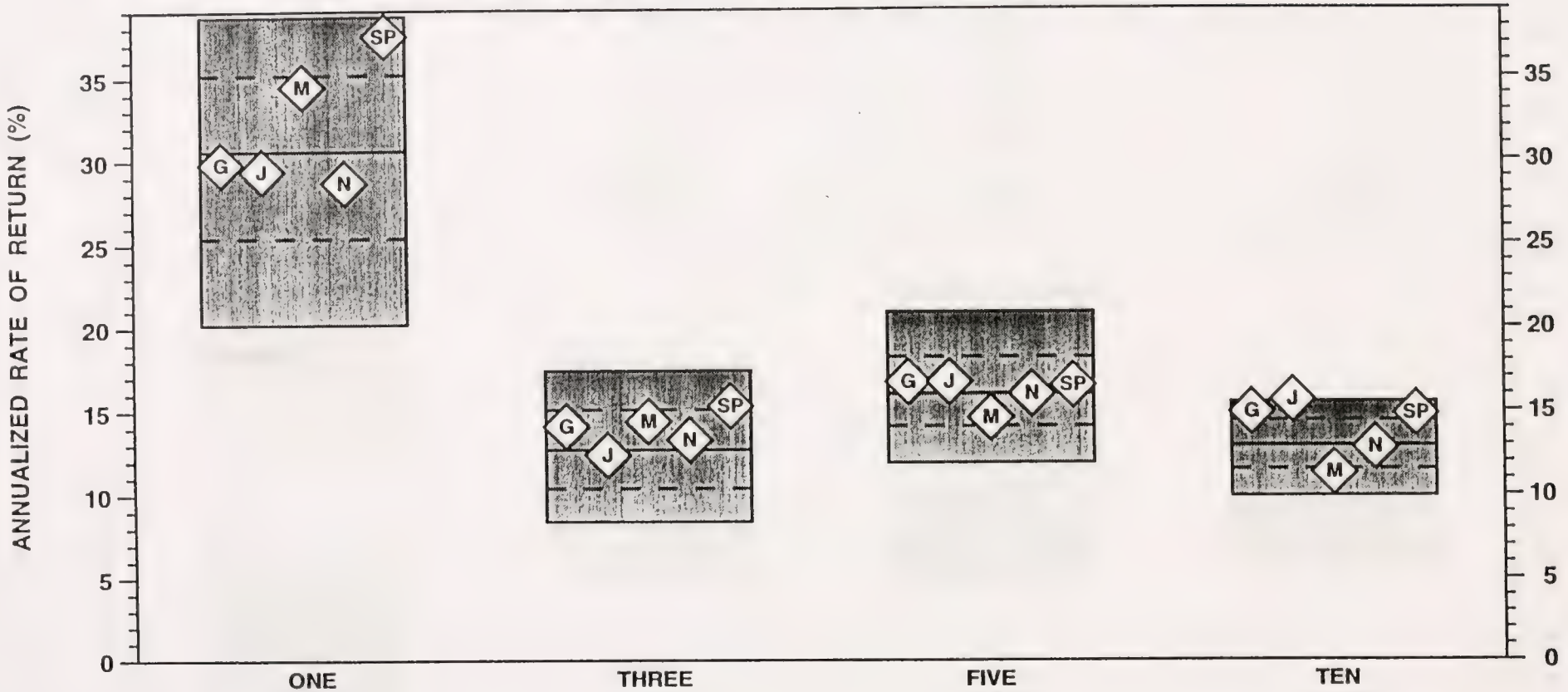
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		38.7	17.4	20.9	15.5
25th Percentile		35.2	15.1	18.2	14.4
MEDIAN		30.6	12.7	16.0	12.9
75th Percentile		25.4	10.4	14.1	11.5
90th Percentile		20.2	8.4	11.9	9.9
AIM WEIN	AW	35.4	11.4	14.6	15.8
DREYFUS	D	35.8	9.8	13.2	11.6
FID-CONTRA	FC	36.3	17.8	24.1	19.4
FID-MAGELL	FM	36.8	18.8	20.4	17.4
S & P 500	SP	37.5	15.3	16.5	14.8

CADENCE GROWTH FUND UNIVERSE

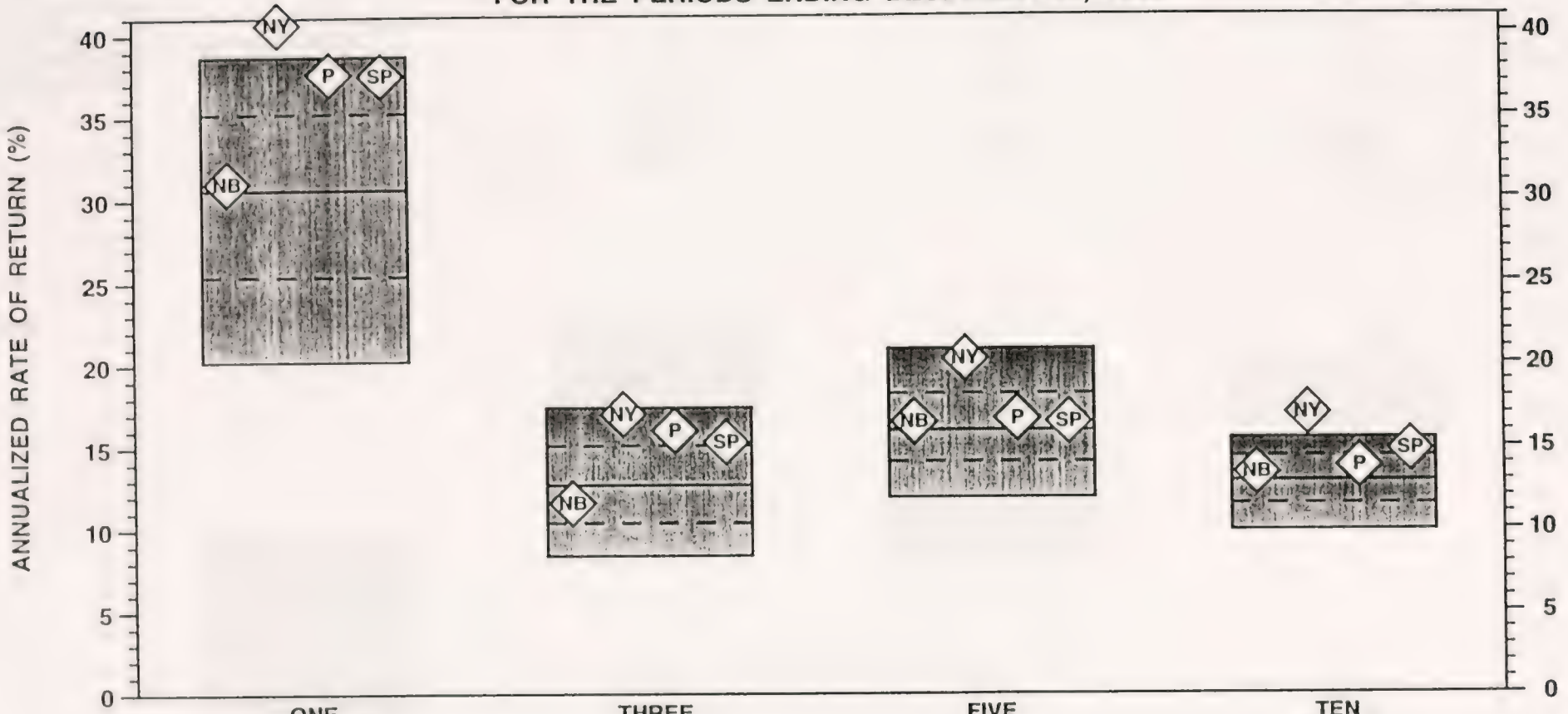
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile	38.7	17.4	20.9	15.5
25th Percentile	35.2	15.1	18.2	14.4
MEDIAN	30.6	12.7	16.0	12.9
75th Percentile	25.4	10.4	14.1	11.5
90th Percentile	20.2	8.4	11.9	9.9
GFA G	29.8	14.1	16.7	14.9
JANUS J	29.4	12.4	16.7	15.6
MFS M	34.5	14.4	14.6	11.3
NATIONWIDE N	28.7	13.3	16.0	12.8
S & P 500 SP	37.5	15.3	16.5	14.8

CADENCE GROWTH FUND UNIVERSE

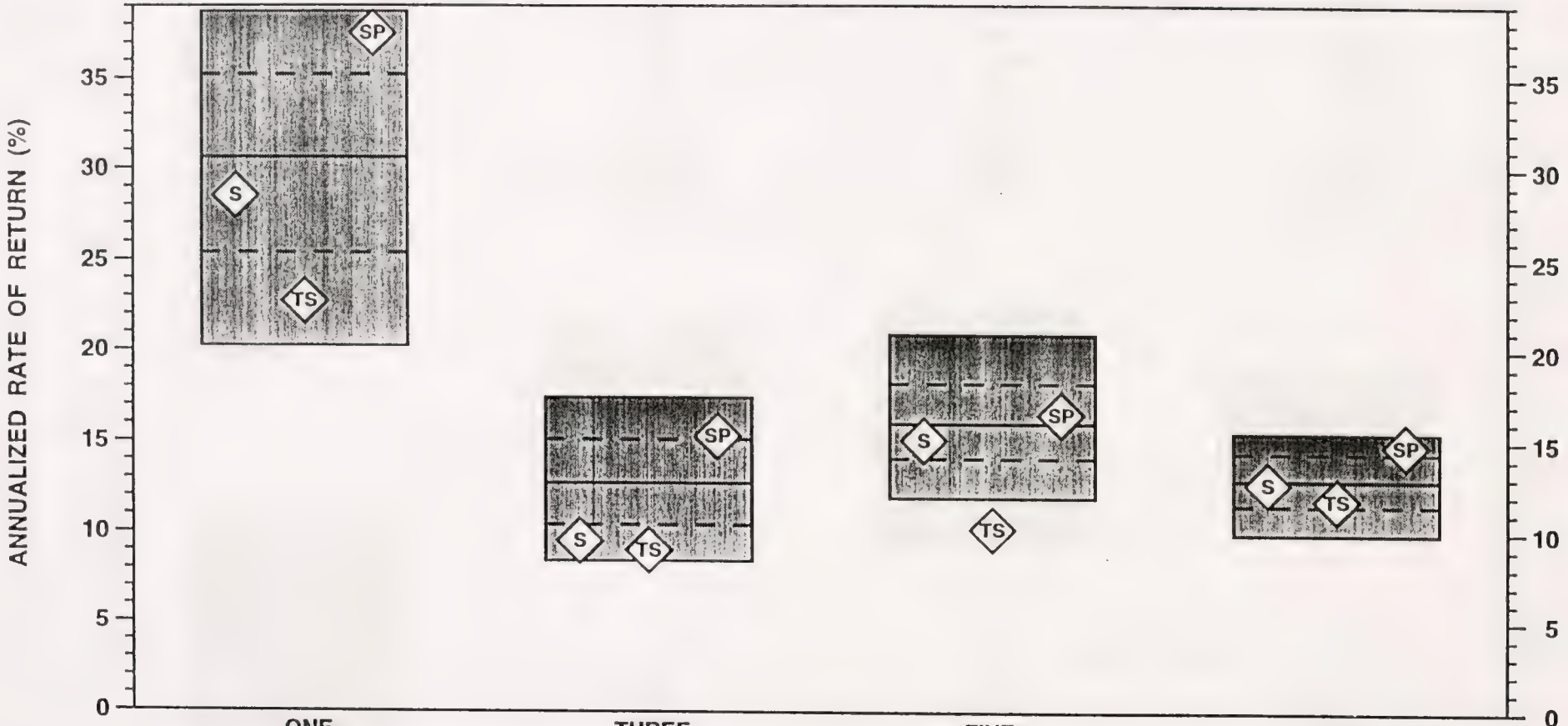
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		38.7	17.4	20.9	15.5
25th Percentile		35.2	15.1	18.2	14.4
MEDIAN		30.6	12.7	16.0	12.9
75th Percentile		25.4	10.4	14.1	11.5
90th Percentile		20.2	8.4	11.9	9.9
NEUB/BERMN	NB	31.0	11.6	16.5	13.4
NY VENTURE	NY	40.6	17.0	20.3	17.0
PUTNAM	P	37.6	16.0	16.7	13.8
S & P 500	SP	37.5	15.3	16.5	14.8

CADENCE GROWTH FUND UNIVERSE

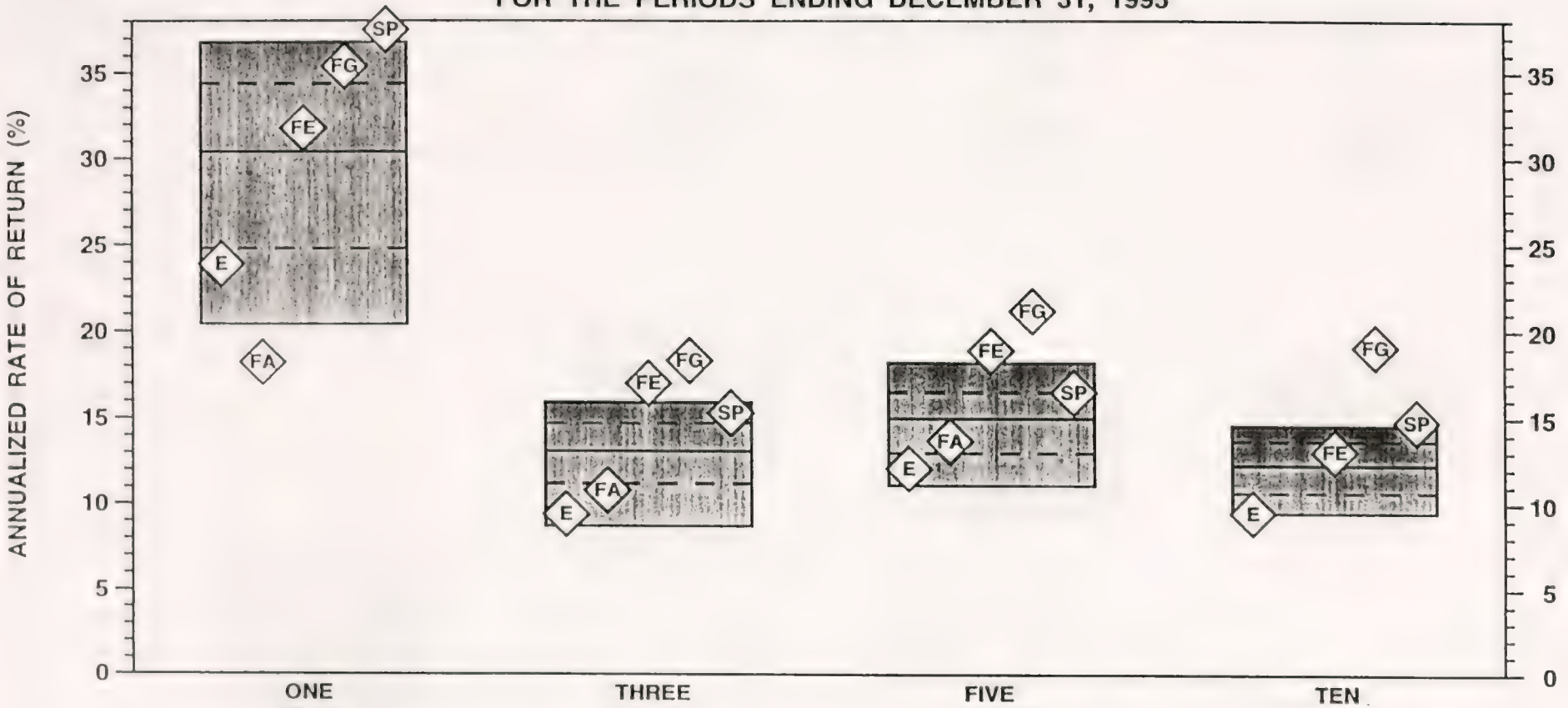
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile	38.7	17.4	20.9	15.5
25th Percentile	35.2	15.1	18.2	14.4
MEDIAN	30.6	12.7	16.0	12.9
75th Percentile	25.4	10.4	14.1	11.5
90th Percentile	20.2	8.4	11.9	9.9
SELIGMAN S	28.5	9.5	15.1	12.7
TCI-SELECT TS	22.7	9.0	10.2	11.8
S & P 500 SP	37.5	15.3	16.5	14.8

CADENCE GROWTH FUND UNIVERSE

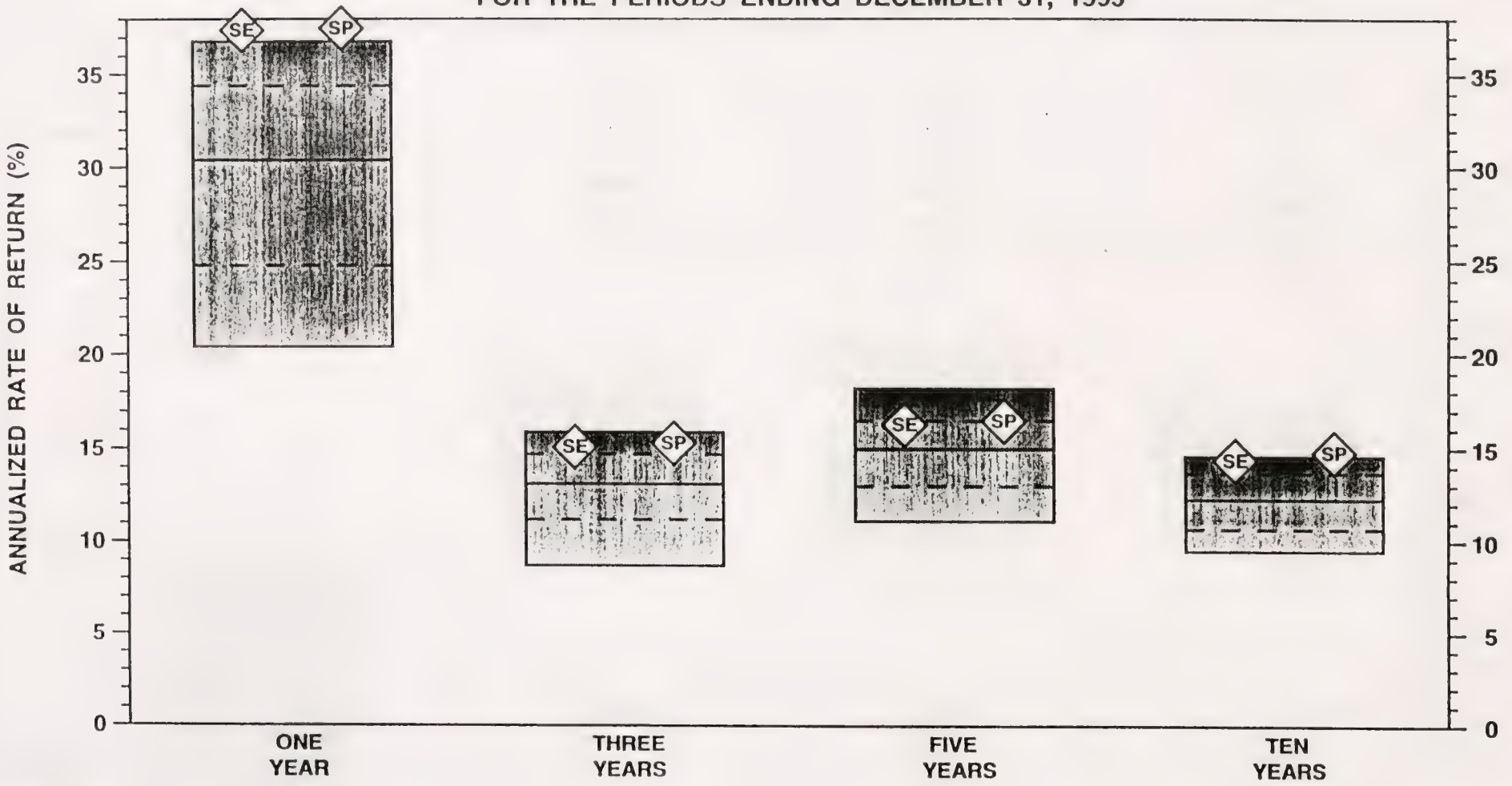
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH & INCOME FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		36.8	15.9	18.2	14.6
25th Percentile		34.4	14.7	16.5	13.7
MEDIAN		30.4	13.1	15.0	12.3
75th Percentile		24.8	11.2	13.0	10.7
90th Percentile		20.4	8.7	11.1	9.5
EVERGREEN	E	23.9	9.4	12.1	9.5
FID-ASSET	FA	18.2	10.8	13.7	N/A
FID-EIF	FE	31.8	17.0	18.9	13.1
FID-GIF	FG	35.4	18.3	21.2	19.1
S & P 500	SP	37.5	15.3	16.5	14.8

CADENCE GROWTH & INCOME FUND UNIVERSE

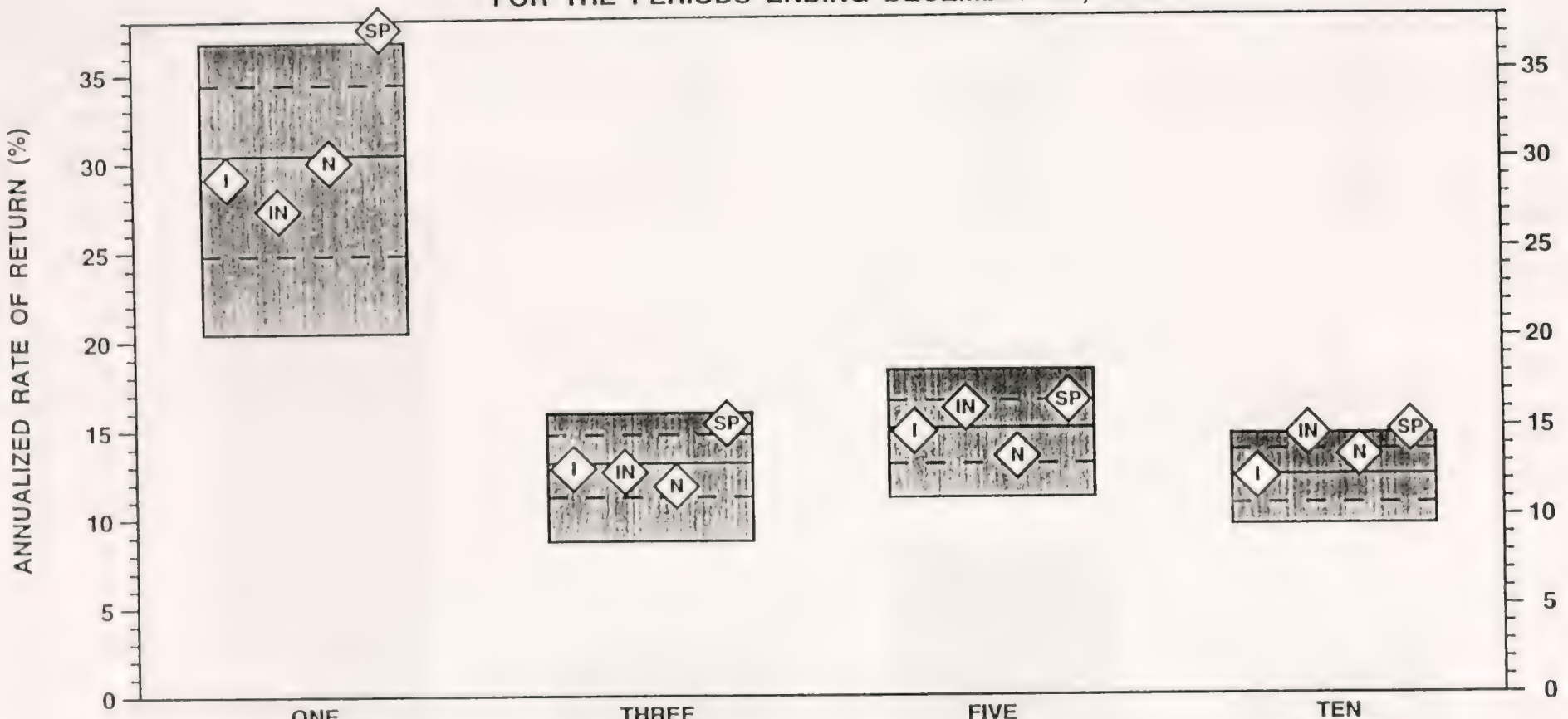
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INDEX FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		36.8	15.9	18.2	14.6
25th Percentile		34.4	14.7	16.5	13.7
MEDIAN		30.4	13.1	15.0	12.3
75th Percentile		24.8	11.2	13.0	10.7
90th Percentile		20.4	8.7	11.1	9.5
SEI	SE	37.4	15.1	16.3	14.4
S & P 500	SP	37.5	15.3	16.5	14.8

CADENCE GROWTH & INCOME FUND UNIVERSE

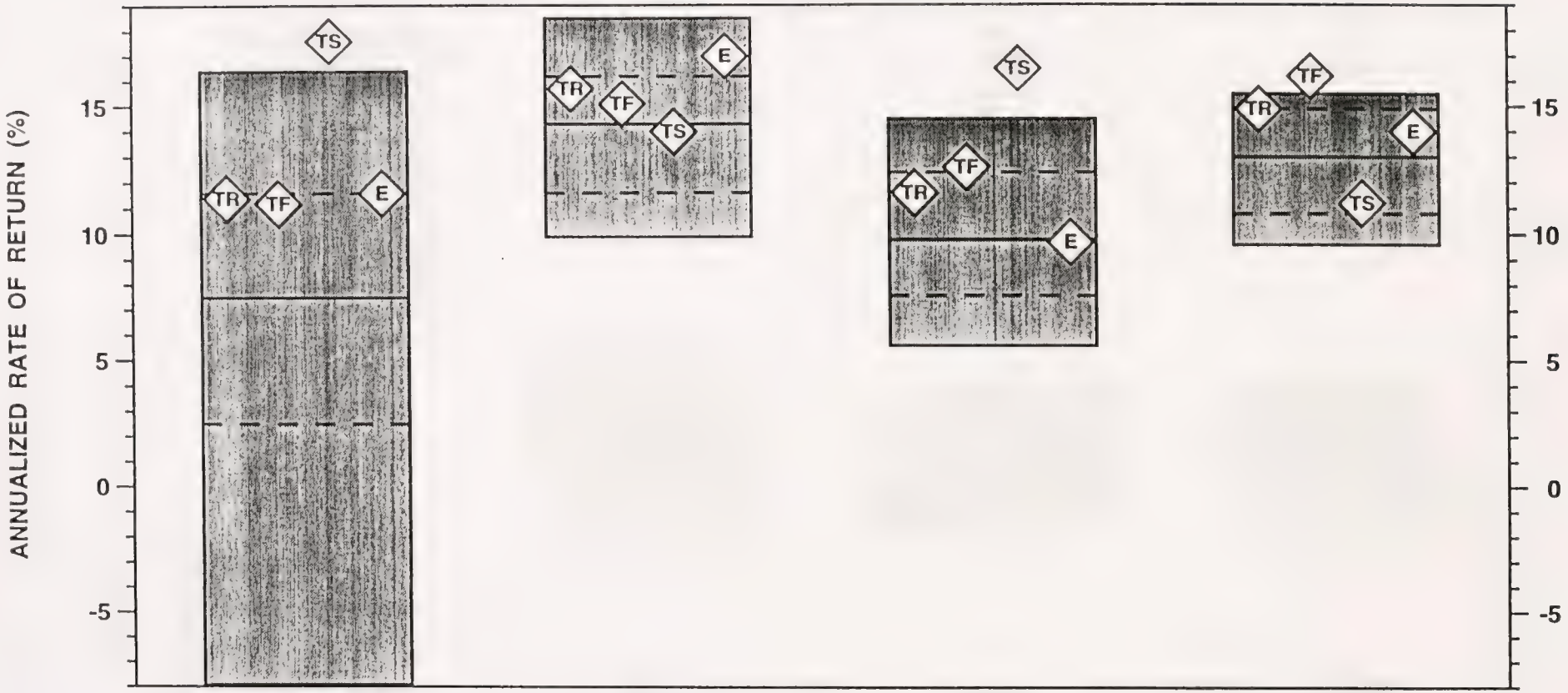
STATE OF MONTANA DEFERRED COMPENSATION PLAN
GROWTH & INCOME FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		36.8	15.9	18.2	14.6
25th Percentile		34.4	14.7	16.5	13.7
MEDIAN		30.4	13.1	15.0	12.3
75th Percentile		24.8	11.2	13.0	10.7
90th Percentile		20.4	8.7	11.1	9.5
IFA	I	29.1	12.8	14.8	12.2
INVESCO	IN	27.3	12.6	16.1	14.6
NATIONWIDE	N	30.0	11.8	13.4	13.4
S & P 500	SP	37.5	15.3	16.5	14.8

CADENCE GROWTH & INCOME FUND UNIVERSE

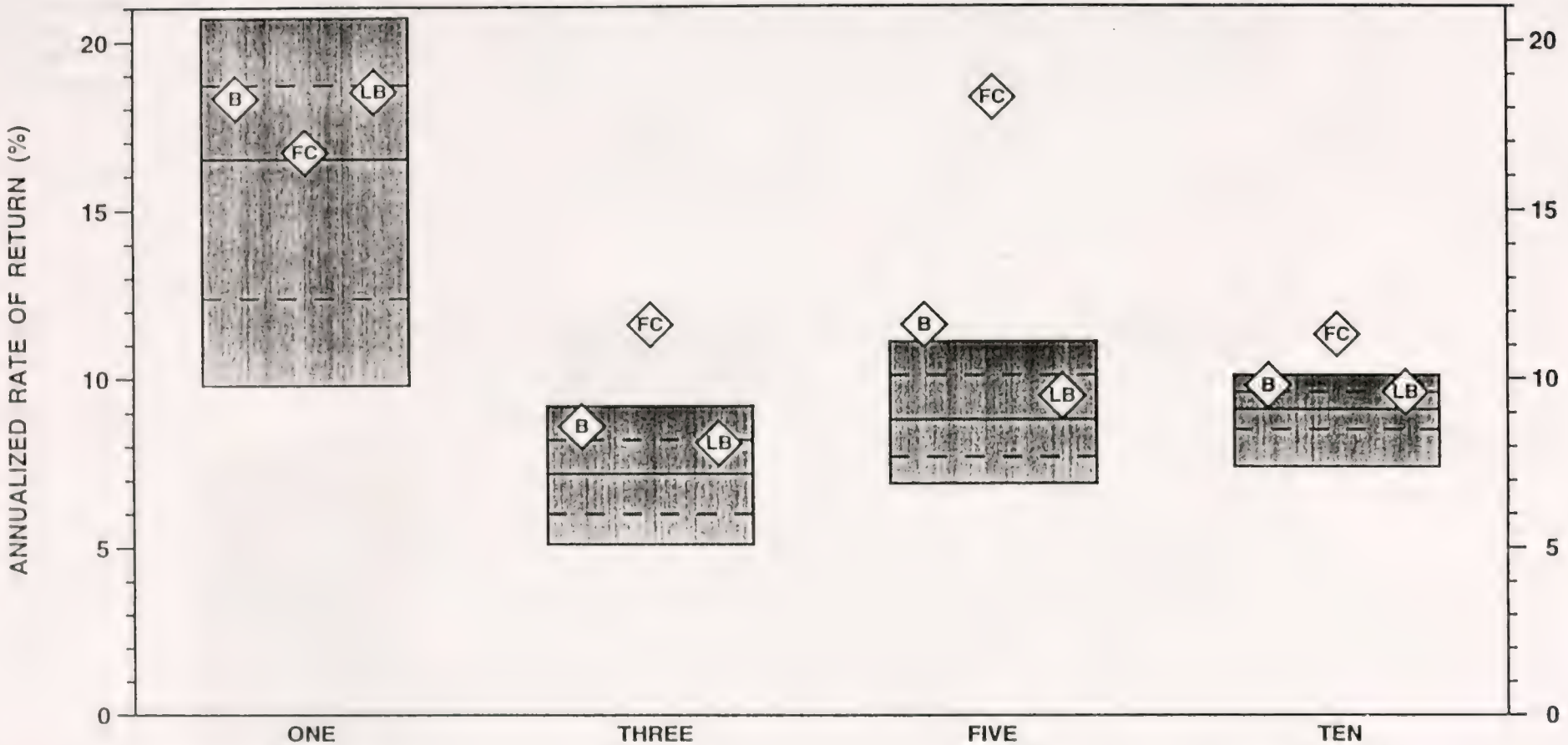
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INTERNATIONAL EQUITY FUND PERFORMANCE
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		16.4	18.5	14.5	15.5
25th Percentile		11.6	16.2	12.4	14.9
MEDIAN		7.5	14.3	9.8	13.0
75th Percentile		2.5	11.6	7.6	10.8
90th Percentile		-7.9	9.9	5.6	9.6
TRP INTL	TR	11.4	15.7	11.6	14.9
TEMPL-FOR	TF	11.2	15.1	12.6	16.2
TEMPL-SC	TS	17.6	14.0	16.5	11.2
EAFE	E	11.6	17.0	9.7	14.0

CADENCE INTERNATIONAL FUND UNIVERSE

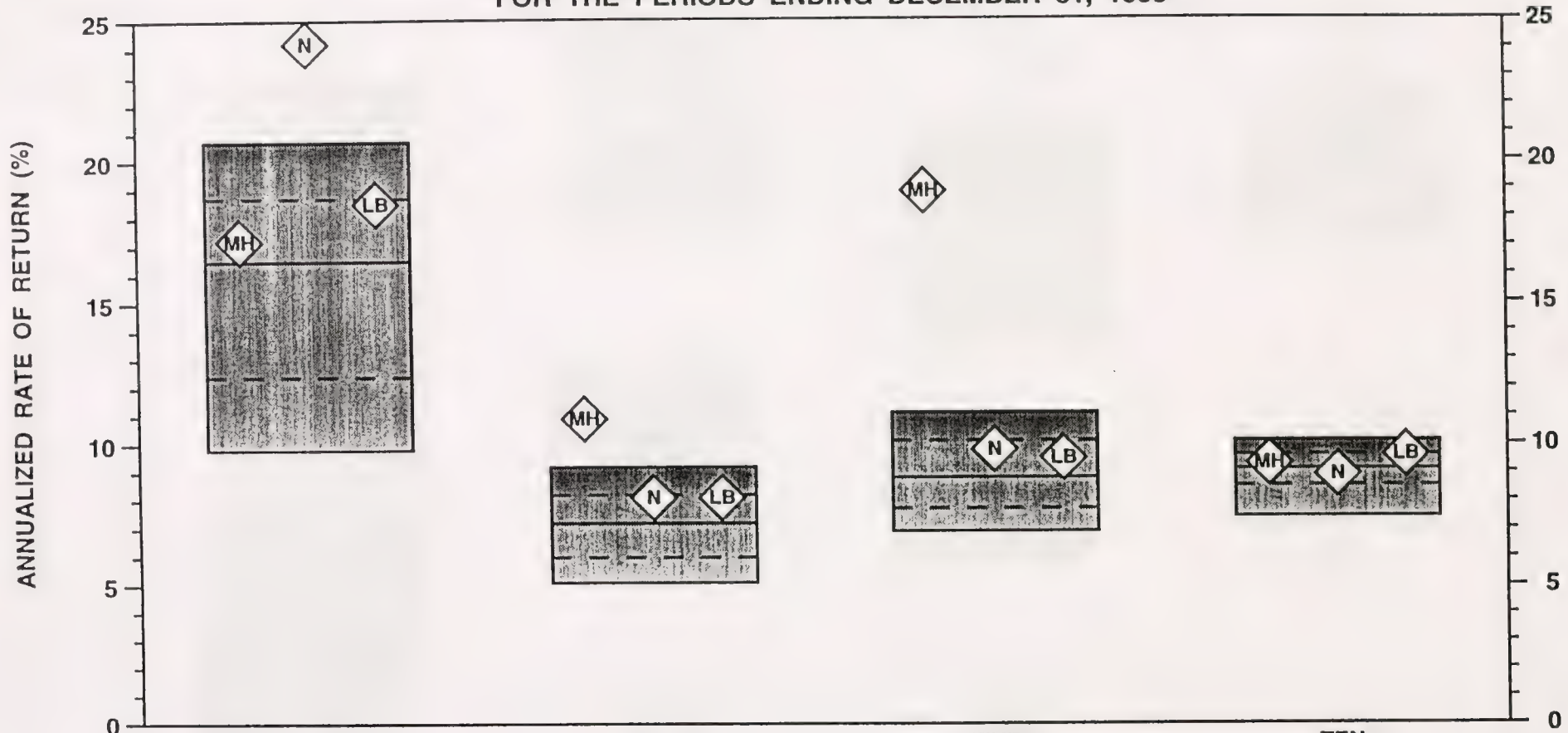
STATE OF MONTANA DEFERRED COMPENSATION PLAN
INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		20.7	9.2	11.1	10.1
25th Percentile		18.7	8.2	10.1	9.6
MEDIAN		16.5	7.2	8.8	9.1
75th Percentile		12.4	6.0	7.7	8.5
90th Percentile		9.8	5.1	6.9	7.4
BFA	B	18.3	8.6	11.6	9.8
FID-C&I	FC	16.7	11.6	18.3	11.3
LB AGGR	LB	18.5	8.1	9.5	9.6

CADENCE CORPORATE BOND UNIVERSE

STATE OF MONTANA DEFERRED COMPENSATION PLAN
INCOME FUNDS RISK/RETURN ANALYSIS
FOR THE PERIODS ENDING DECEMBER 31, 1995



		ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS
10th Percentile		20.7	9.2	11.1	10.1
25th Percentile		18.7	8.2	10.1	9.6
MEDIAN		16.5	7.2	8.8	9.1
75th Percentile		12.4	6.0	7.7	8.5
90th Percentile		9.8	5.1	6.9	7.4
MFS-HI	MH	17.2	10.9	18.9	9.3
NATIONWIDE	N	24.2	8.1	9.8	8.9
LB AGGR	LB	18.5	8.1	9.5	9.6

CADENCE CORPORATE BOND UNIVERSE

State of Montana
Deferred Compensation Plan
Fund Expenses

Fund Name	12B-1	Mgmt fee	Other fees	Total fees
Aggressive Growth				
AIM Constellation (Institutional Class)	0.00%	0.62%	0.07%	0.69%
Janus Twenty	0.00%	0.67%	0.35%	1.02%
Massachusetts Inv Grth Stk A	0.23%	0.31%	0.22%	0.76%
Putnam Voyager A	0.25%	0.55%	0.30%	1.10%
20th Century Growth Investor	0.00%	1.00%	0.00%	1.00%
20th Century Ultra Investors	0.00%	1.00%	0.00%	1.00%
Growth				
AIM Weingarten A (Institutional Class)	0.00%	0.61%	0.04%	0.65%
Dreyfus Third Century	0.00%	0.75%	0.42%	1.17%
Fidelity Contrafund	0.00%	0.70%	0.30%	1.00%
Fidelity Magellan	0.00%	0.76%	0.23%	0.99%
Growth Fund of America	0.24%	0.38%	0.13%	0.75%
Janus	0.00%	0.65%	0.27%	0.92%
MFS Growth Opportunities A	0.13%	0.43%	0.29%	0.85%
Nationwide Growth	0.00%	0.50%	0.18%	0.68%
Neuberger&Berman Manhattan	0.00%	0.69%	0.26%	0.95%
Davis NY Venture A	0.00%	0.20%	0.00%	0.20%
Putnam Investors A	0.25%	0.61%	0.13%	0.99%
Seligman Growth A	0.23%	0.49%	0.28%	1.00%
20th Century Select Investor	0.00%	1.00%	0.00%	1.00%

Fund Name	12B-1	Mgmt fee	Other fees	Total fees
Index				
SEI Index S&P 500 Index	0.05%	0.15%	0.05%	0.25%
Growth and Income				
Evergreen Total Return	0.00%	1.00%	0.18%	1.18%
Fidelity Asset Manager	0.00%	0.72%	0.32%	1.04%
Fidelity Equity-Income	0.00%	0.44%	0.28%	0.72%
Fidelity Growth & Income	0.00%	0.52%	0.30%	0.82%
Invesco Industrial Income	0.25%	0.49%	0.18%	0.92%
Income Fund of America	0.23%	0.32%	0.10%	0.65%
Nationwide	0.00%	0.50%	0.12%	0.62%
Income				
Bond Fund of America	0.22%	0.37%	0.10%	0.69%
Fidelity Capital & Income	0.00%	0.71%	0.25%	0.96%
MFS High-Income A	0.21%	0.45%	0.32%	0.98%
Nationwide Bond	0.00%	0.50%	0.21%	0.71%
Government Bond				
Federated GNMA Instl	0.00%	0.40%	0.22%	0.62%
Federated US Gov: 2-5 Instl	0.00%	0.40%	0.14%	0.54%
International				
T. Rowe Price Intl Stock	0.00%	0.70%	0.31%	1.01%
Templeton Foreign Fund	0.24%	0.63%	0.27%	1.14%
Templeton Smaller Co Grth Fund	0.24%	0.75%	0.37%	1.36%
Money Market				
Nationwide Money Market	0.00%	0.45%	0.25%	0.70%

CONSIDERATION OF ALTERNATIVE MANAGEMENT OF THE FIXED INVESTMENT OPTION

Mercer was requested to analyze the feasibility of the State providing and maintaining a fixed investment alternative to the Nationwide Fixed Fund for the participants of the fund. This fund would be managed by the State Board of Investments as a replacement to the current general account annuity with the insurance company.

This section comments on the options of the transfer of the investment management responsibility of the fixed option from the current provider, Nationwide, to the State Board of Investments or another third party investment manager. We will also address the alternatives available and the pros and cons of each.

Participant counts in the Nationwide Fixed Account option for the last three years are detailed below together with corresponding cash flows in and out of the account and end of year balances.

NATIONWIDE FIXED ACCOUNT

Year	Active Participants	Payout Status
1993	4,538	486
1994	4,696	535
1995	4,825	653

(000's) Year	Annual Deferrals	% Total	Withdrawals	Net Exchanges	Ending Balances	% Plan Assets
1993	$7,729	86.3%	$5,046	($119)	$84,785	87.9%
1994	$7,576	82.4%	$6,145	($1,375)	$91,011	86.7%
1995	$6,517	78.8%	$6,131	0	$97,951	83.6%

Deferrals into the Fixed Fund account have decreased fifteen percent (15%) over the past three years and currently represent approximately 79% of total annual deferrals. Conversely, the deferrals into the variable fund accounts have

increased over the same time from 13.7% of total deferrals to 21.2% of deferrals in 1995. Actual net asset gain in the account has been relatively static net of the investment earnings. Fund balances increased only 7.3% in 1994 and 7.6% in 1995.

Current Investment Manager Fees

Asset fees for management and of the Nationwide Fixed Account were previously disclosed as 0.55%. These fees have been transferred to an undisclosed basis but we can presume have remained the same. Not included in this figure are any deferred sales charges that would be incurred if the contract was terminated and a distribution requested. This charge is scaled from 2% to zero after 7 contract years and will be eliminated on the contract expiration date of December 31, 1996.

The actual investment expense charges to the fund are not disclosed and not exactly known at this time. It should be noted that comparable asset fees for an insurance company general account fixed annuity are typically 1.00% to 1.30% and simply netted from credited interest rates.

The fee structure with Nationwide seems relatively high compared to other non-insurance related funds offering stable value products. The average investment fee that outside stable value funds typically charge range from 20 to 30 basis points. Additionally, investment management fees for comparable bond funds range between 30 to 50 basis point. This included wrap fee to provide book value stability currently ranging from 15 to 20 basis points

Fixed Fund Investment Management (Alternatives)

- Continue to use Nationwide or another similar provider as sole source provider of annuity product.
- Discretionary management through the State Board of Investments (SBI).
- Discretionary Management through a third party provider in a form other than through a single general account fixed annuity.

Presently the funds invested in the fixed option are held in a General Account fixed annuity contract with Nationwide. Under this contract the State is the policyholder and as such is a general creditor of Nationwide. It does not own individual assets nor does it have title to any individual securities. Also, any market value investment gains losses are not passed through to the plan or its participants, immediately, but amortized for some period to smoth the impact to the crediting rate.

If the State is to explore internal management of a fixed option in lieu of Nationwide or a similar insurance contract, we presume that the State would employ a diversified investment strategy with more modern stable value products such as Guaranteed Investment Contracts ("GICs") or Synthetic Guaranteed Investment Contracts ("SGICs") or Separate Account Contracts. We have, therefore, assumed that discretionary management of the fixed or stable value fund would be through the use of a diversified portfolio of investment products.

NATIONWIDE - FIXED FUND RETIREMENT CONTRACT

1. Advantages of Current Fixed Structure

- Administratively easy since investment provider maintains plan's records.
- Assets and records are all in one location.
- Participants receive one interest rate and less potential confusion.
- Need to track credit ratings on only one carrier.
- No need for State or Council to set investment objectives and guidelines for portfolio strategy.

2. Disadvantages

- Exposure of total portfolio ($100 + million) to the credit standing of one carrier.
- No risk diversification.
- No ability to verify real earnings of the portfolio.
- No ability to determine actual charges, fees or allowances charged to the portfolio.
- Limited ability to move funds out of fixed option at participant level.
- Limited ability to move funds out of fixed option at the Plan level.
- No ability to value underlying assets at real market value in the event of termination. Contract imposes artificial market value adjustment formula.

While the crediting rate from Nationwide has been good over the past few years (annualized return from 1991 to 1995 - 7.865%), the annualized return for a comparable index, the Lehman Brothers Aggregate Bond index, was 9.5%. While this index is not generally compared to stable value or general products directly, it does provide an approximation of the returns

of the underlying general account assets. The spread between the annulaized Nationwide fixed account and the Lehman Brothers Aggregrate Bond Index is approximately 160 basis points before considering asset fees.

DISCRETIONARY MANAGEMENT

The current contract with Nationwide has provided the State with a competitive fixed investment option without the requirement usually associated with separate investment account managers. If the State decides to terminate this contract and pursue management then a number of issues need to be addressed. Some of these issues are outlined below:

- Review of Investment policy statement and guidelines - (i.e.: GIC products, use of synthetics, minimum credit quality, cash levels, portfolio diversification, etc...).
- Flexible -- integrate State's objectives with manager process.
- Sophisticated liquidity analysis required.
- Credit research -- overlay with State's broad guidelines.
- Contract review and due diligence.
- Active portfolio strategy and tactics -- rate anticipation, curve positioning, duration management, credit risk valuation, etc.
- Use of multiple products, GICs, floaters, GIC alternatives (fixed maturity and evergreen), cash.
- Portfolio monitoring, ongoing credit review and evaluation.
- Flexible -- allows State to invest in new products or have ability to do so.
- State can own title to assets.
- Easier to terminate and move assets if necessary

STATE BOARD OF INVESTMENTS - AS INVESTMENT MANAGER

Currently the Montana State Board of Investments (SBI) is responsibile for the investment of all state funds, both retirement and non-retirement. Total funds as of June 1994 were approximately $4.8 billion. The fixed income portion of these funds exceeded $3.9 billion. The following points outline the advantages and disadvantages of in-house management.

ADVANTAGES OF IN-HOUSE MANAGEMENT THROUGH SBI

- Potential higher crediting yield to participants as a result of lower fees.
- State absorbs transactional expenses.
- Extensive expertise in fixed income sector.
- Lower fees possible.
- Retain control over investment strategy.
- Staff is familiar with needs of program and participants.
- Asset fees may adequately offset additional hard expenses for SBI.
- Wrap providers for synthetic contract construction may be available for this structure.

DISADVANTAGES OF IN-HOUSE MANAGEMENT THROUGH SBI

- Credit research availability? Likelihood of limited additional credit research over rating agencies.
- Contract negotiation expertise/availability.
- Liquidity management system to minimize contract charges.
- No management performance records in this sector.
- Communication and administration requirements.
- Assumption of fiduciary responsibility and liability.
  - Performance
  - Liquidity
  - Default risk
- Requires expertise in stable value market especially in working with deferred compensation plan.

- Limited value added through active portfolio management strategy.
- Dedication of resources -- part time business?
- No ability to deflect participant dissatisfaction if performance suffers or credit default.

Advantages of Discretionary Management - Independent outside manager

- Full dedication of resources.
- Transfer some fiduciary responsibility from State.
- Retain control of portfolio strategy through specific investment guidelines and credit criteria.
- Contract review and due diligence.
- In the market daily.
- Verifiable track records.
- Research and development of stable value products.
- Independent in-depth credit research.
- Experience with stable value market.

Disadvantages of Discretionary Management - Independent outside manager

- Department gives up some control.
- Low fee on large asset base is substantial.

The ability or practicality of this option depends in large part on the decisions of the State with regard to the assets presently invested in the Nationwide contract. In order for a manager, either the SBI or an independent outside manager, to effectively manage the assets there must be a critical mass of funds to invest. Given the gradual redeployment of deferrals to the variable options and the level of withdrawals, it would appear that there will not be significant cash flows available under fixed option to make management of an individual portfolio practical.

The State could use a commingled GIC fund which would provide for liquidity and diversity but this would negate the need for SBI management. To make it practical for discretionary management of a fixed or stable value investment option the State will need to address the existing Nationwide contract. If that contract were terminated or gradually liquidated additional funds could be freed for discretionary management.

Alternative Funding Vehicles

Other stable value products the State may wish to consider are:

- GICs -- a diversified portfolio
- GICs and SGICs -- a diversified portfolio
- Separate account insurance contracts
- Bonds

All of the above with the exception of a pure bond fund would be maintained on a book value basis. This would allow the participant to see an interest rate but not experience any fluctuation in his or her principal. A managed bond fund would be valued as market value and would experience over time, fluctuations in market value. We would not recommend the Plan offer a fixed option with a market value basis. Therefore, if the portfolio was to be managed by SBI or an independent manager we suggest a diversified portfolio with a book value basis.

We would recommend that initially the State continue to outsource the investment management of the fixed option. Prior to selection of any manager we recommend that the State determine what investment vehicle should comprise the fixed option, that it adopt an investment policy, credit criteria and guidelines for the option. These would form the foundation for management of the fixed option. The manager will be expected to manage the assets in the fixed option within the policy and guidelines established by the State. Periodically the manager will provide the State with sufficient information to determine compliance with the guidelines.

INVESTMENT TRANSFERS AND PAYOUTS

- Investment transfers are movements of assets from one investment option or vehicle to another. Restrictions or transfers occur at two levels -- participant and plan. In evaluating transfers there are two terms that frequently come into play:

  - Deferred sales charge (DSC) -- Can exist at both the plan and the participant level. On the participant level, DSCs allow the provider to recoup its expenses for enrolling (or paying another party to enroll) new participants in the plan. They also exist to discourage transfer of money to other providers.

  - Market value adjustment (MVA) -- Protects the investment provider from the withdrawal of large amounts of assets. A large withdrawal would presumably require that the investment company sell assets, the sale of which might have to occur at a loss. The MVA is designed to make up this loss. Instead of an MVA, contracts often allow for withdrawal of assets, at book value, over an extended period of time, such as five years.

Investment Transfers-Participant Level

- Because there are no competing investment options, participants can transfer freely from one investment option to another using the voice response system provided by Nationwide. The only limitation is the 10% plan level annual aggregate transfer limit on the fixed annuity. This limit will come into play only if transfers in a given year exceed 10% of the prior year's ending balance. As mentioned earlier, we suggest that this possibility be communicated to participants, at least on the memorandum of understanding.

Investment Transfers-Plan Level

- The State cannot currently move assets invested in either the fixed or variable annuity without terminating its contract with Nationwide. If the contract is terminated (which requires 30 days written notice), payment of the variable assets will be made immediately. Assets in the fixed annuity, at the election of the State, will be paid in 60 monthly installments or in a lump sum subject to a market value adjustment. The method of determining the MVA is disclosed

in the contract. The impact of the MVA is dependent on interest rates at the time of termination, however, they are structured in the carrier's favor.

- Although a deferred sales charge currently exists under the contract, the charge will be eliminated with the end of the 1996 contract year. As mentioned earlier, the State has negotiated a contract with favorable terms. Note: Any change to the fixed investment option will have to take the existence of this MVA into account.

- Frequently annuity contracts such as the State's do not include a provision for the continuation of recordkeeping. The State's contract does provide for this recordkeeping although the .55% asset based fee would be reassessed.

Payouts

- There are two basic forms of benefit payouts other than lump sums payments:

  - Annuity Payouts: This is a payout in which the payment duration is guaranteed and the insurance company collects a mortality and risk charge.

  - Systematic Withdrawals: Payments in which the return on the unpaid balance is based on the current investment return of the fund.

- Differentiating between the types of payouts can be confusing. A great deal of the confusion stems from the fact that historically annuity providers usually waived participant level deferred sales charges if the participant annuitized with the insurance company. This resulted in the development of annuities that provided for payment only for a short fixed period with no life contingency. Paying benefits in the form of an annuity allowed the insurance company to make a profit over the payment period, even if it was short. This same profit margin does not exist under systematic withdrawals.

- The State Plan provides for the normal range of payout options. The options and the number of participants purchasing each annuity is summarized below:

Purchased Annuities						
	1993		1994		1995	
	Annuitants	Amount	Annuitants	Amount	Annuitants	Amount
Des. Period	15	$830,428	20	$1,219,146	18	$935,618
Life/10 yr. Certain	2	$18,128	2	$33,259	0	$0
Life/15 yr. Certain	0	$0	2	$45,893	1	$12,049
Life/20 yr. Certain	2	$77,551	1	$45,942	1	$111,280
Joint & Survivor 100%	0	$0	1	$29,781	2	$59,302
Life Income	0	$0	1	$30,089	0	$0
Total	**19**	**$926,107**	**27**	**$1,404,110**	**22**	**$1,118,249**

Non-purchased Payouts			
	1993	1994	1995
Lump Sum	$926,769	$676,432	$590,690
Non-purchased Annuity Payments	$2,826,438	$3,795,607	$4,290,793
Total	$3,753,207	$4,472,039	$4,881,483

Please note that information regarding the number of participants electing non-purchased payouts by specific option was not readily available.

➢ It is interesting to note that of the participants who selected annuity payouts, 80% selected designated period annuities. The internal rate of return for these annuities range from 4.08% (for 3 years) to 5.85% (for 20 years). The internal rate of return for the designated amount annuity is 5.5% per year. While there may be instances in which a participant needs the security of an annuity payment for a fixed period or amount it is normally a costly option compared to the systematic withdrawal payment option. Note: The current interest rate on the fixed option is 7.15%.

- Nationwide pays DADCO no commissions on annuity payments, which avoids the possibility of an enroller steering participants to annuities.

Promotional Materials

- The plan booklet is visually attractive. The booklet is short, and in our experience, short is best. Employees tend to lose interest quickly and not pick up materials if they appear to be too detail oriented. Our specific comments are:

  - The booklet text could be written in more user friendly language. For example, there is currently reference to "Taxes ... are not due until receipt of funds begins...."

  - The booklet also indicates that DADCO will contact the participant when it is time for his or her benefits to start. We suggest the booklet mention the difficulty in locating participants when it is time to distribute benefits and encourage the participant to keep his or her current address on file with DADCO and to contact them at their benefit commencement date.

  - The recap provides information that is not mentioned in the booklet.

  - The booklet indicates that there is a $12 administrative fee. It is our understanding that this fee has been waived.

  - The payroll illustration is at the back of the booklet. Since this is important to an employee deciding whether or not to enroll, we suggest that it be moved to the front of the booklet for a more "chronological" layout of information.

- We suggest arranging the booklet to first address the important highlights and plan features -- importance of retirement planning, sources of retirement income, replacement income needed and how the Plan can meet participant retirement needs, using graphics and charts to emphasize key concepts. Then close with a few of the commonly asked questions that may explain a concept in more detail than in the highlights section. We would suggest breaking up the copy with more charts and graphs -- not just the payroll illustration but also showing how money can grow and the cost of waiting to participate, the impact of increasing contributions over time, etc.

- The communication materials fail to reinforce the message that this is the State deferred compensation plan. Most communication materials (other than the Plan booklet) are printed on DADCO stationary. This serves to reinforce the identity of DADCO but not that of the State. We suggest the State explore a unified communication theme with a logo that would identify the State program. The stationary used for communication, particularly benefit and projection illustrations, should echo this theme.

- In 1991, August was "Deferred Compensation Month." We did not receive evidence that this designation continued in future years. If the designation has not been continued, we suggest that the State consider a regular program of awareness which would include the designation of a "Deferred Compensation Month." It is particularly important that such activities continue on a regular basis so that they gather momentum.

Quarterly Statements

- The individual participant statement format is dated and not visually attractive. We suggest the use of colored statement paper that visually identifies the statement, preferably in a style and color that reinforces the unified theme of the other communication materials. A vertical layout would be easier for participants to read.